

# Strategic Alliances in Eastern and Central Europe



Akmal S. Hyder  
Desalegn Abraha

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# **STRATEGIC ALLIANCES IN EASTERN AND CENTRAL EUROPE**

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# **STRATEGIC ALLIANCES IN EASTERN AND CENTRAL EUROPE**

BY

**AKMAL S. HYDER**

*University of Gävle, Sweden*

**DESALEGN ABRAHA**

*University of Skövde, Sweden*

SERIES EDITOR

**PERVEZ N. GHAURI**

2003



Pergamon

An Imprint of Elsevier Science

Amsterdam – Boston – London – New York – Oxford – Paris  
San Diego – San Francisco – Singapore – Sydney – Tokyo

ELSEVIER SCIENCE Ltd  
The Boulevard, Langford Lane  
Kidlington, Oxford OX5 1GB, UK

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First edition 2003

#### Library of Congress Cataloguing in Publication Data

A catalog record from the Library of Congress has been applied for.

#### British Library Cataloguing in Publication Data

A catalogue record from the British Library has been applied for.

ISBN: 0-08-044208-0

∞ The paper used in this publication meets the requirements of ANSI/NISO Z39.48-1992 (Permanence of Paper).

Printed in The Netherlands.

## **To the memory of**

Blata Gebrekidon Weldegaber, Bofta Hailu, Tekeste Gebrekidan, Abraha Gebrekidan and Timnit Gebrekidan

Desalegn Abraha

Syed Abdul Halim and Khurshid Alam Jahangir

Akmal Hyder

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## Acknowledgments

We wish to thank many people who have encouraged and assisted us in the development process of this book. First and foremost we are grateful to Professor Jan Johanson who has inspired us all the way with guidance and research ideas relating to international business. Our colleague Lars Hjärne deserves special thanks for being a source of continuous support and a discussion partner on research and practical issues.

Knowing about the Swedish firms engaged in alliances in Eastern and Central Europe has been a difficult and time-consuming job. The Swedish Export Council provided us with important information about Swedish investment in ECE and guidelines in localizing right firms. Our thanks go therefore to the Swedish Export Council in Stockholm and its branch offices in many ECE countries. Even Swedish embassies in some ECE countries have made a significant contribution in this regard. We also owe a great debt to a number of ECE embassies in Stockholm for providing us with a list of Swedish firms engaged in alliances in the region. Further, we are highly grateful to the managers of the Swedish firms who offered themselves to be interviewed for hours being constrained with their tight schedules and other business engagements.

We are very grateful to Professor Pervez N. Ghauri, editor of the series, for his invaluable suggestions in planning, developing and getting this book completed. We would also like to thank administrative editors at Elsevier Science Ltd., Becky Lewsey and Debbie Raven for support and practical guidance while the manuscript of the book was being prepared. Our appreciation goes also to our young colleagues Nina Shamirani, Linda Andersson and Jenny Wiklund for their valuable support with layout, figures and tables, and going through the manuscript and other details.

Our family partners Anjuman Hyder and Zayd Tsegai deserve special thanks for their patience, encouragement and support in the efforts to make this book

*viii Acknowledgments*

possible. Our heartiest appreciation goes to our beloved children Bana, Jonathan, Fanus, Zelib Desalegn, and also Afif, Labib and Raqiq Hyder.

Akmal S Hyder  
Desalegn Abraha

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## **Series Editor's Preface**

We have published a number of important volumes on strategic alliances in general. This volume is devoted to exploring new perspectives on alliances among Western firms and firms from Eastern Europe. After more than a decade of liberalization in this region, Western firms still find it difficult to do business in a number of Eastern European countries.

The idea of devoting a single volume on strategic alliances in Eastern Europe came from Akmal Hyder and Desalegn Abraha, as they have done an extensive research in studying Nordic firms in these markets. They first explain the strategic alliances concepts and methodological issues of their empirical studies and then explain the particular conditions in Eastern Europe. After explaining their empirical findings they draw conclusions. We believe they provide rich insight into this difficult market and set the base for future research.

Pervez N. Ghauri  
*Series Editor*

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## Preface

The publication of this book is timely and appropriate because it deals with establishing long-term business relationships in Eastern and Central Europe (ECE) and alliances with local partners with different attitudes, beliefs and ways of thinking. ECE is interesting for at least three reasons: it's a big market with a 70% literate population; it represents a huge market for private enterprise and finally, ECE officials recognize and acknowledge the need for an economic transfusion. At the beginning of the 1990s many Western firms entered ECE hurriedly, and with confidence without thinking about the complexities associated with this area. Many promising business ideas failed due to lack of knowledge about the local environment, including social, cultural, political and human resource-related issues. Western managers who have working experience in ECE acknowledge that a good preparation is necessary before setting up business ventures in the region. Further it is required that proper networks of relationships are established and competence in dealing with local people, authorities and markets are gradually developed. Keeping these important thoughts in mind, this study focuses on relationship development and ways in managing operations between western and eastern partners.

Initially, all ECE countries followed the socialist ideology and had almost the same economical structure, but during the last 12 years of transition, there have been many changes within these countries. Success in adopting market economy and changing policies varied among the countries, which created certain gaps. It has therefore become important to know why some countries have done so well while others have fallen behind. Many times it is difficult to know with accuracy how things are going with these countries due to lack of sufficient research and information. This study sees the collaborations as a clear step to reduce the risk of investment by foreign firms and to gradually get accepted by the ECE governments and the people. However, there is a basic difference in the management style between these two areas and therefore

issues such as how these dissimilar partners make things go, what results they achieve and what they really contribute to the development and transformation process in ECE are stressed in this book.

Many research works have emphasized the dynamic characteristic of an alliance, but surprisingly, no fruitful attempt has yet been made to cover this issue. And in the case of ECE, this absence is crucial as partners have a totally different background and therefore have different ways in doing business. In fact, ECE is not only different from the Western countries but also from the other developing countries. Development and application of a relevant research to comprehend alliances in ECE is therefore put as one of the main objectives of this work. To fulfill this goal, a tool in explaining, understanding and finally describing the formation, development and functional mechanism of a strategic alliance in ECE has been designed from a process perspective. This conceptual framework has been applied in this work to go into depth in capturing fundamental issues and functional patterns of the alliance activities.

As one of the main reasons for alliance formation is the *exchange of complementary resources* among the partners, no study on an alliance can be complete and justified unless this vital issue is duly considered. Commitments of the partners relating to formation and operation of the alliances come under assessment to observe whether they are realized or not. Many times fulfillment or failure to provide the committed resources is linked to the overall performance of the alliances. However, the exchange is an ongoing process, and therefore is subject to change from time to time depending on the changed requirements of the alliances as well as of the partners. The change of need and the resources are seen as a consequence of *learning* that takes place on the part of alliance partners. The learning can occur on common understanding or on the basis of individual motivation. In this book, focus is given on learning that may take place through exchange of partners' resources in the east-west alliances.

One major strength of this book has been to consider each ECE country on its merits and demerits rather than considering all countries as a homogenous group. There is a wide cultural gap between Westerners and the former socialist country people. But there is also cultural heterogeneity among the ECE countries. The Baltic States, which are considered to have a similar culture, may just be a myth. This study has shown that there is a big cultural difference between Estonia and Lithuania, and therefore foreign firms operating in both the countries, have adopted different business strategies. With the support of the previous studies and the current investigation, three clusters of ECE countries have been suggested for the convenience of investment by Western firms. *Fast adapting countries* have quickly adjusted to the conditions of the market

economy and therefore offer most favorable environment for investment in the region. *Low adapting countries* have largely remained unchanged and therefore have not yet become an attractive area for foreign investment. To engage in alliances in the slow adapting countries requires a firm to have enough resources and a long term investment perspective. Tolerance and obstinacy are two highly valued qualities by foreign firms to operate in the slow adapting countries. This book reveals that in this category there is a complete need to give the responsibility to local people in dealing with local matters. Any attempt to assume this task by the foreign partner will be catastrophic and is likely to result in failure. The remaining cluster *medium adapting countries* are characterized by mixed success and they are on the way to go in the direction of fast adapting countries.

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# **Part 1**

## **Introduction and Foundation**

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# Chapter 1

## Background of the Study

It is the introductory chapter of the book presenting the background and justification of this study. First, strategic alliances are shortly addressed and then the importance of Eastern and Central Europe in the international business is highlighted. Aims, research problems and limitations of the study are discussed in three different sections. The chapter concludes with a disposition on the rest of the chapters in the book.

### 1.1. Introduction: Strategic Alliances

The cooperative agreements for mutually beneficial goals between two or more organizations have come to be known as strategic alliances. In broad terms, strategic alliances are long-term collaborations between firms for attaining some strategic objectives. Varadarajan & Cunningham (1995) define strategic alliance as the pooling of specific resources and skills by the cooperating organizations in order to achieve common goals, as well as goals specific to the individual partners. A strategic alliance or strategic network may be regarded as a purposeful and binding cooperative agreement between autonomous firms, for the objective of improving competitive advantage and long-term profitable value creation for all cooperating parties (Borch 1994). Firms will be attracted to cooperate when they need complementary resources from others to avail themselves of opportunities. A strategic alliance covers a broad area of collaborations starting from joint activities within an informal setting to a formal structured equity joint venture.

Alliances are formed for a variety of reasons, which include entering new markets, reducing manufacturing costs, developing and diffusing new technologies rapidly (Walters *et al.* 1994); getting access to new markets, and learning new management and partnering skills (Medcof 1997); and sharing risk and defending against competitors (Elram 1992). In fact, learning and borrowing ideas from partners is part of realizing the full value of the relationship (Kanter

#### **4 Strategic Alliances in Eastern and Central Europe**

1994). But to learn successfully depends on a partner's ability and willingness to learn. A key driver for creating and sustaining strategic alliances will be a shared perception of opportunity, potential impact on market values, high returns and low exit barriers (Newman & Chaharbaghi 1996).

Strategic alliances are becoming an increasingly important and a recognized means of conducting international business (Kaynak *et al.* 1995). In surveys of its members over the last few years the Industrial Research Institute has found that, in each year surveyed, between 45% and 49% of respondents have projected increasing their alliance participation (Industrial Research Institute's Annual R&D Trends Forecast 1995). Alliances can be the key to future prosperity (Medcof 1997), and this understanding is now being shared by both local as well as multinational companies at an increasing rate.

But how does an alliance function as a collaboration form? Most researchers find it complex to operate. Alliances are not tools of convenience (Ohmae 1989). Despite the enthusiasm and despite the favorable number, though, the incidence of expensive and messy alliance failures is surprisingly high, and a reality that alliance 'players' must consider seriously (Medcof 1997). The works of Bleeeke & Ernst (1995), and Klein & Zif (1994) indicate that international alliances face a high degree of failure rate. Hyder & Ghauri (2000) claim that the reasons for this failure are understandable because partners who contribute resources and all other support to the alliances, have different organizational, social, and cultural backgrounds. If the alliance partners come from different countries, it may intensify the differences making the operations difficult. Communication problems, mistrust, and operational and cultural differences are some common obstacles in international alliances (see Kanter 1994). Lorange & Roos (1991) state that alliances may face operational difficulty for at least three fundamental reasons:

- (1) decisions taken by more than one organization;
- (2) different corporate cultures meet; and
- (3) parent firms have conflicting interests.

In the field of internationalization, many researchers have studied different aspects of strategic alliances. A strategic alliance is nothing but a relationship between partners, thus it is of interest to investigate how this relationship develops over time. Alliances involve shared risks, which require mutual adjustments that cannot be specified in advance (Lewis 1990). Ring & Van De Ven (1994) have called the collaborative relationship a process and focus on its emergence, growth and dissolution. A strategic alliance, from the above perspectives, remains to be an interesting research object, for understanding its

mechanism, complexity, risks and benefits, and learning how to handle it in a professional way for participating firms' competitive strength, profitability and growth.

## **1.2. Eastern and Central Europe (ECE)**

Competition is becoming fiercer and complex both in the domestic and international markets. This notion is supported by various researchers such as (Bradley 1999; Kotler 1997). The diversity and market complexity make firms' operations more uncertain and risky. In addition to operating in highly competitive markets, business entities are continually seeking to develop existing markets, discover new ones, accumulate complementary resources, find other uses of the existing resources, and get access to new technology and technological development. All these require identification and continuous follow-up of customer and competitor characteristics and interests, and changes related to them.

After the fall of the Berlin wall in November 1989, the overall economic and political situations have changed tremendously, particularly in Europe. This change came at a time when Western firms in general exposed to saturated markets in the West and had frequent problems with profitability. Many Western firms went into the Eastern and Central Europe (ECE) quickly to have the "first mover advantage" and therefore did not have enough time in making proper market research to justify their investment decisions. Initially, all ECE countries have followed the socialist ideology and have almost the same economical structure, but during the last 12 years (1989–2001) of transition, there have been many changes within these countries. The success in adopting market economy and changing policies varied among the countries which created certain gaps. It has therefore become important to know why some countries have done so well while others have fallen behind. Many times it is difficult to know with accuracy how things are going with these countries due to lack of sufficient research and information. This view is supported by the recent publication of The Economic Intelligence Unit (May 15, 2000). Because of its communist past and the many new states created since 1990 in ECE, there are no reliable data that could be used to establish a long-term growth trend, and studies tend to include a large amount of guesswork (*ibid.*).

Foreign investors in ECE countries come across a business environment that is totally different from developed country markets. This is because transition has established as yet a fragile institutional framework due to market immaturity, a weak legal system, and corruption (Estrin & Meyer 1998).

### **1.3. Importance of ECE and Foreign Direct Investment**

As the industrialized country markets are getting more saturated, multinational companies have shown interest for emerging regions such as South East Asia, Latin America, and more recently China and Central and Eastern Europe (ECE) to extend market and come across low cost factors of production. Many ECE countries, specially those who managed to adopt the market economy a little bit earlier, have become an attractive area for foreign investment. Transition economies offer unique opportunities for businesses willing to take risks associated with economic transformation (Estrin & Meyer 1998). There are certain advantages with the ECE countries. First of all, they have small physical distances from the West European countries. Distance is an important factor considering the cost of transportation and maintaining timely delivery of goods and services. This reduces the transaction uncertainty the customer might face and is one way of influencing buyer-seller relationships (Ford 1990). As competition is getting tougher, firms are eager to ensure highest production efficiency, which can only be achieved by close collaboration between buyers and sellers. There is also a positive psychological effect of nearness as problems can be solved through physical presence instead of telephone conversation and sending fax and e-mail.

Second, the ECE countries together offer a huge market which has been left more or less non-exploited over the years. ‘First mover advantage’ has therefore been an important target for many multinational companies to ensure a better position than their competitors. For the privatization of the local industries in the area, many Western countries have come forward with financial and managerial support. This support has even opened an easy way for the multinational companies to enter into ECE market with limited effort, cost and risk. Similarly, foreign direct investment inflows are of crucial importance for the process of reintegration of ECE in the global marketplace (Marinov & Marinova 1999).

According to Jain & Tucker (1994), there are three fundamental drivers that encourage multinationals to look to ECE for trade and investment. First, ECE is a big and relatively prosperous market, with a 70% literate population. It is a region of tremendous natural and economic resources. Second, ECE represents a virtually untapped market for private enterprise. Third, and perhaps most importantly, ECE officials recognize and acknowledge the need for an economic transfusion.

Not all ECE countries receive the same importance or have succeeded to implement privatization and to adopt more pragmatic policies toward market economy. For example, in the leading economies in the ECE — the Czech

Republic, Hungary and Poland, a new class of buyers is growing, not only in numbers, but also in sophistication (see Business Week 1998). These countries along with Estonia and Slovenia are regarded as the first potential membership candidates for European Union from ECE. But what is significant to note is that the total importance of the region for foreign direct investment is growing. In 1992, the region received US\$4 billion, which increased to US\$11 billion in 1995 and is expected to reach US\$16 billion in 1997 (see Estrin & Meyer 1998). Jones *et al.* (2000) found FDI inflows to the region 12.4 billion in 1996 and 17.1 billion in 1997. Germany has been one of the main developed countries which has substantially invested in ECE. The ECE region experienced the most spectacular growth of German FDI in the 1990s, increasing its average share from 0.1% in the 1983/1989 to 7.4% in 1990/1996 (Tüselmann 1999). The German trend of investment provides a good reflection of the general investment in ECE.

#### **1.4. Differences between ECE and Western Economies**

Although advantages are many, the ECE offer several constraints. A firm considering or is already engaged in such a country has to carefully go through various delicate situations. One major disadvantage lies with the host country environment itself. There is a wide range of difference between East and West concerning political, social, cultural and economical factors. Nevertheless, though many East European countries have adopted a market economy, there are still many important decisions, especially in connection with business, taken by the government. The mentality of the people is gradually changing but it has a long way to go. Unless the social and cultural gaps are minimized, understanding of people between East and West will be difficult. There is a basic difference in the management style practiced in these two areas and therefore any direct import of Western management, whatever may be the quality, is likely to be unsuccessful. Although the economic situations are, in general, improving at a varied rate, the purchasing habits and capacity of the local people are still different from that of Western Europe.

Foreign investors in ECE face a business environment that is fundamentally different from any advanced market economy (Estrin & Meyer 1998). Gieb & Pfaff (2000) who have studied strategic management in ECE, urge for a cultural reconditioning of the employees. In the new environment, to expect local employees and low-level managers to make individual decisions, to participate with initiative and imagination, and to take risks is asking for miracles (*ibid.*).

## **1.5. Strategic Alliances and ECE**

Until the late 1960s, multinational firms engaged to meet major requirements through internalization, thus all market expansion mainly took the form of wholly-owned subsidiaries. This trend changed afterward by the increased adoption of both international and domestic joint ventures where at least two partners establish a separate entity for sharing cost, risk and benefit.

But as the technical changes are now more rapid, and market and competition have become global, some new forms of organizations providing opportunity for different types of collaborations have come to exist. This is a shift from one company's perspective to two or more companies' cooperation and collaboration as a means of reducing production costs, acquiring critical resources, increasing market shares, entering new markets, developing a strong position in the markets and serving the markets better through the use of new technology and technical competence. Strategic alliances, the popular name of the recent type of collaborations, even include joint ventures as an important alternative. Strategic alliances are considered to be the most appropriate form for technical collaboration, joint product development, market entry and market development, seeking strategic resources, etc. Today, many multinational firms use some form of joint operations in contrast to the wholly-owned operations which they frequently used before. One typical example of a firm which has made a dramatic shift in the form of operations, i.e. from wholly-owned operations to strategic alliances is IBM. According to Barney (1996), IBM was widely known for its complete preference for wholly ownership. But, it has changed its ownership strategy and by 1992, it had four hundred strategic alliances with various companies in the domestic as well as in the international market.

Considering the merits of the ECE countries on one hand and the uncertainties on the other, we assume that foreign firms will be more willing to collaborate with local firms than to establish wholly-owned companies in this region, at least in the initial stage. There is evidence that many Western firms have entered the East European and Central European market through strategic alliances mainly to overcome the local constraints (Lyles & Baird 1994; Fahy *et al.* 1998). The logic is that the local managers can handle day-to-day problems better and the foreign firms get time to concentrate on the technical and efficiency matters of the local operations. But what happens in reality is a matter of further investigation.

In general, firms may be better off utilizing shared-control modes of entry in ECE at the present time. Through the use of the shared-control modes managers can:

- (1) reduce the firm's exposure to political and legal risks;
- (2) develop a greater understanding of the existing ECE marketing infrastructures;
- (3) minimize their investment risks; and
- (4) increase their ability to participate in local ECE markets by entering otherwise closed networks for distribution, gain access to limited supplies of raw materials, and gain some level of protection against changes in government attitudes toward foreign firms (Brouthers *et al.* 1998).

However, maintaining relationships between the partners, and joint decision making have often been described as a delicate part of strategic alliances. If partners fail to solve major problems, the alliance will face difficulty in operating efficiently. Walters *et al.* (1994) note that strategic alliances have experienced a high failure rate and Varadarajan & Cunningham (1995) indicate that strategic alliances have experienced both success and failure. Varadarajan & Cunningham maintain that the realities highlight the need for research that can shed insights into the factors underlying the success and failure of alliances, as well as issues relating to systems, structures, and controls conducive to effective management of alliances. Joint venture forms of entry provide an effective means of gaining local knowledge and easing a firm's entry into unfamiliar cultural settings (Erramilli 1991; Brouthers *et al.* 1998).

## 1.6. Aims of the Study

Depending on the growing importance of the strategic alliance, especially in the international market, many researchers have tried to explore the issue both theoretically and with empirical studies. But what we lack in these studies, is the absence of a well-developed conceptual framework which can be applied to study strategic alliances in a wider perspective. Many authors like Harrigan (1986), Hennart (1988) and Ring & Van de Ven (1994) have emphasized the dynamic characteristics of an alliance, but surprisingly, no fruitful attempt has yet been made to cover this issue. In our view, a study of a strategic alliance at a certain point of time may contribute essential insights of a certain issue, but will certainly fail to give a proper view of a real-world situation. Furthermore, we concentrate on the ECE, which is totally different from the Western countries and even from the other developing countries. Development and application of a relevant research to comprehend alliances in ECE becomes therefore more than essential.

We have already pointed out in the earlier section the importance and the increased rate of alliance formation in ECE. Thus, there is a need to design a

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tool in explaining, understanding and finally describing the formation, development and functional mechanism of a strategic alliance in this region. Consequently one of the main purposes of this study would be to develop a conceptual framework from a process perspective. This purpose, however, is not made as an explicit research question since it functions as a precondition for successfully designing and conducting the underlying study. Another purpose is to examine and describe different environmental factors that can affect the alliance operations positively or negatively in a totally different environment of ECE.

Why firms engage in alliances has always been a fundamental research issue in most of the studies dealing with such types of collaboration. Unless the motives of the partners are known, it is impossible to have a clear idea of the partners' expectations, and reasons for their satisfaction and frustration over the performance of the alliances. It is neither possible to grasp an understanding what contributions the participating firms will make and why. In the context of ECE, host countries are totally different from their Western counterparts on many aspects and therefore the motives of the local associates are likely to be somewhat different than what have been known so far. One important purpose of this work deals with a thorough study of motives in forming alliances.

In this study, emphasis is given on the operation as we have been interested to focus on how alliances are organized, managed and developed. As one of the main reasons for alliance formation is the exchange of complementary resources among the partners, no study on an alliance can be complete and justified unless this vital issue is duly considered. Commitments of the partners relating to formation and operation of the alliances come under assessment to observe whether they are realized or not. Many times fulfillment or failure to provide the committed resources are linked to the overall performance of the alliances. However, the exchange is an ongoing process, and therefore is subject to change from time to time depending on the changed requirements of the alliances as well as of the partners. The change of need and the resources are seen as a consequence of learning that takes place on the part of alliance partners. The learning can occur on common understanding or on the basis of individual motivation. The other two important purposes of this study are therefore to investigate as how the exchange of resources and learning functions in the alliances.

It is usually not the only goal of the partners to see that alliances are successful but they have a keen interest to develop their own competitive strength through the alliances. One such way is to learn from each other and the other way is to establish contacts with other actors. In the international alliances, these contacts are very crucial as both partners find ways to

communicate with different important firms, which hitherto have been totally unknown to them. Partners can get access to each others' networks or can develop their own contacts through their presence in the alliances. Network development by the partners is also treated in this study as a distinct purpose.

Another purpose, not translated into a research question, concerns the applied conceptual framework and how it relates to the result of the study in drawing conclusions. We assume that the adjustment will be an important aspect of the study because the components of the framework are mainly chosen from the international business, not particularly focused on the ECE. At least two types of changes may be necessary. Totally new concepts/variables may need to be added or some existing one may be replaced by a new variable. The other change concerns the context, i.e. the relationship between the variables may change or importance of the variables may shift.

## **1.7. Research Issues**

The earlier studies on strategic alliances have addressed important issues like resources, compatibility of goals, commitment, trust, and the functioning pattern of such relationships but without taking into consideration the wider context in which they operate. The main focus here is that if firms entering into strategic alliances want to create successful relationships and to achieve organizational goals, they have to mobilize their networks to develop the required complementary skills and resources. Another argument is that the relationships created in connection with strategic alliances need to be considered from a process perspective. The research problem is therefore related in describing the strategic alliances in a systematic way right from the very beginning to the final position of the alliances.

More specifically, the research issues to be dealt with in this project are:

- (1) What are the main motives in forming strategic alliances in Eastern and Central Europe and to what extent do these motives get realized? Do these motives need to be changed, and if so, why?
- (2) How do the alliances function through the exchange of resources between the partners and how do they cope with constraints and opportunities? Here identification, explanation and thorough description of the events critical to the development of alliances are specifically focused;
- (3) How does learning take place within strategic alliances as well as on the part of alliance partners in connection with expectation and contribution of the resources?

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- (4) How does the network develop and contribute to individual partners' competitive strength and competence development and also to the overall performance of strategic alliances?
- (5) How does the general environment affect the operations and functioning of the strategic alliances and how do the partners deal with its impacts?

### **1.8. Limitations**

This study uses a broader definition of a strategic alliance which includes as discussed, all long-term collaborations, but mergers and acquisitions are excluded from the definition. Logic behind this limitation is simple. Acquisitions are not collaborations because the acquiring firm takes over the ownership of the acquired firm. On the other hand, merger is the most intimate level of collaboration which leads to the creation of a single entity by ceasing the independent identity of the collaborating firms. Only inter-organizational relationships are considered as strategic alliances, therefore mergers and acquisitions do not fall within the scope of the study.

Another limitation is related to our concentration on the manufacturing firms or firms selling manufactured products. This type of firm requires active collaboration between partners when new products are developed or introduced, existing products are improved or new markets come under consideration. As this study focuses on the alliance process and aims to capture the different aspects of the relationships, we find this limitation necessary.

Domestic alliances have been used by firms for quite a long time which need less effort and strain on the part of the participants. In such alliances, partners know each others' resources and competencies and also their limitations. Due to increased competition, firms need to be far better by seeking competence and knowledge in the international field. It is not even enough that firms have good products and strong desire to sell products in the international market. Doing business internationally is complex, uncertain and risky but many times can be promising and highly prospering. Although alliances are advantageous, the task to operate international alliances is not easy as partners have varied backgrounds and practice different ways in doing business. Considering the specialty and growing importance of international collaboration, this study therefore is limited only to international alliances, more specifically between Swedish firms as foreign partners and firms from Eastern and Central Europe as local partners. We have limited to Swedish firms because the research is

conducted in Sweden. But we can argue that Swedish companies going international very well resemble a similar category of firms from other developed countries.

The fourth limitation is a shortfall of this study because we only look on the strategic alliances from the Swedish partners' point of view. We have to make this limitation considering time, cost and involvement of so many countries in ECE. However, we have aimed to compensate the shortcoming by interviewing different people involved in the alliances from the same Swedish company whenever possible. This helps to cross-examine versions of different executives in sketching a more acceptable picture of the alliances. Documents, memos and other written material also contributed positively in this connection.

## **1.9. Disposition**

Part 1 of the this work continues with Chapter 2 which deals with gathered knowledge and previous studies on strategic alliances. It offers first a number of theoretical explanations of alliance formation and then takes up some vital issues such as resources, learning and network, closely related with this form of collaboration. Chapter 3 concerns a methodological discussion that includes the process of data collection, data presentation, reliability and validity of data, and analysis and finally drawing conclusions. General environment is presented in Chapter 4. This chapter is based on the social and political situation, cultural factors, economic development, privatization, and foreign direct investment in the ECE. The whole ECE region is divided into three groups mainly depending on the economic growth and adaptation to the market economy in facilitating presentation and analysis of the data. A conceptual framework is presented in Chapter 5 which ends the first part of the work.

Three chapters which deal with data presentation constitute Part 2. The first chapter includes cases about fast adapters which have been the most advanced countries in the ECE. Chapter 7 of this part concerns medium adapters that have succeeded to attain a moderate economic growth. The least successful ECE countries are named slow adapters which are discussed in the next chapter.

The final part also includes three chapters. The cases presented in the earlier part, are analyzed in the first chapter, which is Chapter 9 in the book. The next chapter is devoted to relating the research findings with the literature in the field. Chapter 11, which draws to the end of this work, concentrates on reporting final conclusions. Managerial implications and suggestions for future research are also outlined.

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## Chapter 2

# Knowledge of Strategic Alliances

## 2.1. Definition, Classification and Motives

A strategic alliance is defined as a long-term cooperative arrangement between two or more independent firms that engage in business activities for mutual economic gain (Tsang 1998). The label “long-term” does not refer to any specific period of time, but rather specifies that the intention of the partners is for the arrangement to be more than a transient one. General logic dictates that a firm will prefer to collaborate to get something done by the help of another firm if it would otherwise cost more to do internally. Complementary characteristics of these partner firms, ones that can constitute a fruitful exchange, are therefore a vital part in the alliance formation. To make alliances function and fulfill goals, alliance partners need to ensure that necessary skills and resources are made available. At one extreme, a strategic alliance between two firms can encompass many functional areas; at the other, it may be limited in scope to a single functional area or value activity (Varadarajan & Cunningham 1995).

Strategic alliances are formed for a variety of reasons, including entering new markets, reducing manufacturing costs, and developing and diffusing new technologies rapidly (Walters *et al.* 1994). Alliances occur by necessity, and are engineered to create and exploit new opportunities. The key parameters surrounding strategic alliances are opportunism, necessity and speed. Their ultimate aim is to maintain knowledge (technology, market, production, etc.) leadership whilst minimizing time to market in order to exploit the briefest of business opportunities (Newman & Chaharbaghi 1996). In their conceptual work, Varadarajan & Cunningham (1995) have presented a list of motives for entering into alliances relating either to the market or the resources.

Strategic alliances can be grouped into three broad categories (Barney 1996):

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- *Non-equity alliance* — Cooperation between firms is managed directly through contracts, without engaging in cross-equity holdings or creating independent bodies. Examples are licensing agreements, distribution agreements, R&D collaborations, etc.
- *Equity alliance* — Cooperative contracts are supplemented by equity investments by one partner in the other partner. Through privatization programs, many Western firms have entered into alliances in Eastern and Central Europe by acquiring shares in the existing business concerns.
- *Joint ventures* — Cooperating firms create an independent firm in which they invest individually. Profits from this independent firm compensate partners for this investment. The oldest type of alliance, the joint venture has been practiced widely by multinational firms, as well as those that concentrate only on their own domestic markets.

Varadarajan & Cunningham (1995), specify only two types of alliances, namely joint ventures and inter-organizational entities that involve non-equity alliances; i.e. Barney's second category of equity alliances are incorporated within the joint venture type, and are thus not treated separately. However, Barney's classification is more appropriate for our study because many future alliances in ECE are anticipated to fall within this equity-alliance category.

International strategic alliances are difficult to maintain since partners from different cultures may have different goal profiles. It is not unusual that, despite the presence of requisite mutual interest in making an alliance successful, these differences prove insuperable obstructions. The partners' available resources, their organizations, the role of their social and cultural backgrounds, and the environment in which joint ventures are to operate are more or less unknown to one another prior to formation (Hyder & Ghauri 1989). Serapio & Cascio (1996) have thoroughly examined possible reasons for alliance termination, arguing that alliances typically end for one or more of the following six reasons:

- (1) the alliance is not successful;
- (2) irreconcilable differences between partners;
- (3) breach of agreement;
- (4) the goals/strategies of a partner evolve beyond the alliance;
- (5) a partner needs to exit due to financial reasons; and
- (6) the alliance has met its goals and reached its conclusion.

## 2.2. Some Theoretical Explanations

First, an understanding of why strategic alliances are formed — and what purpose they are supposed to fulfill — is necessary. The research on strategic alliances is still under development, but a few diverse informal theoretical explanations have been offered. One important approach is presented in Transaction Cost Theory (Williamson 1975; Hennart 1988). According to this theory, efficiency, cost minimization, and asset specificity are the major considerations for a firm in deciding whether it will develop specialized capacity within the firm or engage in collaboration with other firms. Williamson (1991) has termed the alliances as the "hybrid mode" of governance. Zajac & Olsen (1993) are critical of the transaction cost viewpoint because it overemphasizes cost minimization at the expense of the value creation aspects of an inter-organizational collaboration. They argue that attention should be shifted to the process by which alliance partners create and claim value (Tsang 1998).

Another approach is driven by the Resource Dependence perspective, suggesting that firms try to acquire control of scarce resources via the help of alliance partners (Pfeffer & Salancik 1978). The purpose is for a firm to reduce uncertainty by attempting to manage its environment through cooperating with key parts of it (Faulkner 1995). This perspective also stresses the need for maintaining control, but in contrast to the transaction cost approach, it emphasizes collaboration as an important alternative in accumulating resources, as no organization is entirely self-sufficient. Hyder & Ghauri (1989) have applied this approach in studying joint venture relationships, and observed that more emphasis should be given to developing understanding and trust in order to get such alliances to function. A weakness of the resource dependence perspective is that it does not address dynamism in the relationships, and therefore cannot cover issues relating to changing relationships due to the occurrence of partners' learning from each other.

A third alternative is Interaction Explanation (Håkansson 1982), which has more recently been extended to network approaches (Johanson & Mattsson 1988; Håkansson & Sneehota 1995). According to interaction explanation, trust, confidence, and adaptability become vital, and social exchanges beyond mere economic rationales is put into focus. Firms are active within these networks for securing resources; however, not all contacts are equally important, thus it is not efficient to give them equal weight and value. Network theory suggests that some relationships will be stronger and longer term, while others will be limited to occasional contacts. In direct opposition to the transaction cost perspective, which concentrates on short term and economical view of

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organizational exchange, this approach recognizes the development of relationships through interactions over time, particularly in consideration with the social context.

Finally, the Resource Based perspective focuses on a firm's resources, viewing strategic alliances as important alternatives for making proper development and deployment of resources (Wernerfelt 1984; Barney 1991, 1996). The underlying argument of this approach is to attain sustained competitive advantage since the relevant resources are heterogeneous. Strategic alliances occur in a variety of forms, but are most frequently (at least implicitly) founded on the resource-based theory (Faulkner 1995). Barney argues (1991) that to ensure sustained competitive advantage, a firm's resources must have the following four attributes:

- (1) value;
- (2) rarity;
- (3) being imperfectly imitable; and
- (4) a dearth of strategically equivalent substitutes.

When a firm is bereft of resources with such attributes, it will seek these qualities from alliances with other firms possessing them.

Strategic alliances can help a firm to enter new industries, avoiding the high costs of creating skills, abilities, and products (Kogut 1988; Barney 1996). Learning, which is a central issue in the resource-based view, has therefore also been recognized as an important issue in alliance formation. Eisenhardt & Schoonhoven (1996) have compared the resource-based and Transaction-Cost approaches on strategic alliance formation, and have come to the following contrasting conclusions:

- (1) strategic and social factors are more important than transaction costs;
- (2) characteristics of the firm (e.g. strategy, top management) outweigh transaction details; and
- (3) a theoretical logic of needs and opportunities overshadows efficiency issues.

It is difficult to say which of the above approaches is best, but it can be safely argued that all are not equally suitable under diverse circumstances. The major strength of the transaction cost theory lies with a firm's capacity to achieve efficiency by having hierarchical control in strategic alliances (such as joint venture); however, control can also be a source of weakness since it can become a hindrance on the other partner to avail itself opportunistically.

Control is also sought in the resource dependence perspective, but mainly for the purpose of curbing uncertainty. An important conclusion is that both approaches seek to build one firm's dominance and individual benefit at the expense of the other partner, without any real interest in the synergistic possibilities the alliance affords. The resource-based view considers firms as bundles of resources and concentrates on how these resources can be organized to attain competitive advantage for the collaborating firms. There are several advantages to this approach. First, it seeks to develop competitive advantage for the collaborating firms. Second, it tries to maximize long-run profits through using and developing firm resources (Tsang 1998). Finally, it creates opportunities for imitation (learning) of resources by partners; however, the degree of such invitation depends on the type of alliance chosen and on the ability of the partners to learn.

As we recognize resources and learning possibilities as the major reasons for alliance formation, the Resource-Based view appears the most suitable for our purpose, but a major weakness of the model is that there is a general difficulty in handling the more dynamic issues of resource creation (Foss 1998). A strategic alliance is a give-and-take process that includes combining and pooling resources, and learning can only take place in an environment where change is encouraged. Another issue, one also related to dynamism, is the inability of the approach to consider an alliance from a continuous-process perspective. However, both issues are major foci of the network approach. According to this view, firms collaborate to develop long-term relationships and to build deeper relationship networks beyond the collaboration in question. We therefore find it advantageous to extend the resource-based perspective with the two central concepts of the network approach — i.e. dynamism and process orientation — to develop our theoretical framework. This is presented in Chapter 5.

### **2.3. Learning in Strategic Alliances**

Strategic alliances are an innovative means for firms to increase their learning (Osland & Yaprak 1995). Two types of learning have been discussed in the strategic alliance literature: the impact of organizational learning on alliances, and learning within the alliances. Lyles (1994) is perhaps the only author to make an important theoretical contribution to the latter type, asserting that learning is a continuous process that builds on the past, attempting to create

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value from experience. She identifies three primary processes of learning that may impact new joint venture formations:

- (1) learning from experience in past joint ventures;
- (2) learning from others' instructions, copying from other firms; and
- (3) "learning by doing," via innovation, experimentation, and other creative ideas.

The complete process will occur only rarely since the partners strive to be sure that they agree regarding both the alliance's form and its operational and management style.

The former type of learning, which concerns the post alliance-formation period, has attracted more attention among researchers working with the learning aspect in alliances. If learning is the underlying purpose, some kind of ownership or involvement in a long-term relationship is necessary for such an intellectual transfer to take place. A *tacit* knowledge — that is, a product of the contributor's informal knowledge and experience — can only be garnered through the establishment of close links with the person or the firm possessing it. Because organizational knowledge is tacit, experimental, and embedded, it is only through the melding of organizational structures (i.e. replicating organizational structure in the new joint venture firm) that this knowledge can be transferred from one partner to another (Varadarajan & Cunningham 1995). Current strategic alliances, and the joint-venture collaborations popular until the mid-1980s, have therefore been identified as a well-established medium for the purpose of learning.

Researchers like Osland & Yaprak (1995), Pucik (1988), Lyles (1994), and Medcalf (1997) discuss different aspects of learning within strategic alliance configurations. Medcalf (1997) takes the view that a firm's long-term alliance strategy focuses primarily on organizational learning of new technical, managerial, and partnering skills, and on improvement of organizational positioning in the evolving landscape of the alliance's activities. He also recognizes entrances into new markets as important motives in establishing an alliance. Even here is an implicit learning objective present, as the foreign partner usually intends to establish local contacts and gather local market know-how as a part of its long-term planning. Osland & Yaprak (1995) have argued that joint ventures appear to be the most desirable structural form of alliance in developing new technologies and transferring sensitive technologies. In summary, learning in the pre-alliance stage concerns the overall process and its management, but post-alliance learning mainly concentrates on specific issues such as technological knowledge, local market know-how, management systems, and distribution channels.

Risk sharing is often said to be an important factor for considering strategic alliances. This is particularly true when a new technology is developed and a substantial investment becomes necessary. The simple idea is that a synergy effect will evolve by joining forces, one which results in time saved and less use of valuable human and financial resources. Partners collaborate in order to either diversify the risks inherent in developing new technologies, or to take advantage of complementary conditions of each partner's developmental skills (Hergert & Morris 1988).

By the help of a qualitative study, Hamel (1991) has put forth important theoretical concepts on learning in international alliances. He discusses three determinants of learning which largely dictates when the learning takes place and with what degree of success it is practiced. The first category, **intent of partners**, concerns the degree of interest partners have in learning from one another. Hamel *et al.* (1989) have examined the learning situation of Western and Japanese companies in strategic alliances. In all cases studied they found the Japanese partners had learned, but that the U.S. and European partners had not. The simplest explanation has been that the Japanese wanted to learn, whereas the Westerners did not share the interest. It is self-evident: to learn, one must want to learn (*ibid.*) It may be a cause of concern for some managers if the intent to learn is asymmetrical since the learning outcome may be unbalanced.

The second determinant is **transparency**, which relates to the openness of a firm to its partner. Whereas intent establishes the *desire* to learn, transparency determines the *potential* for it (Hamel 1991). The final category is **receptivity**, which concerns a firm's overall ability to actually absorb skills from its partner. This issue has also been considered by Pucik (1988), who argues that benefits are unequally distributed due to differences in the organizational learning capacity of the partners. There is evidence that more two-way learning occurs between partners when both are from developed countries than when one partner is from a developed nation while the other is from a developing country (Osland & Yaprak 1995). This is easily conceivable since the technological standards and learning propensities of partners in developed countries are comparatively more likely be aligned *ex ante facto*.

## 2.4. Resources and Strategic Alliances

Tsang's (1998) conceptual work discusses motives for strategic alliances from a resource-based perspective, including the following:

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- (1) creation of rents — which can occur by the combination of complementary resources;
- (2) expansion of resource usage — e.g. an engaged technological resource can be exploited in a new strategic alliance;
- (3) diversification of resource usage — i.e. risks are shared with other partners, making resources free for other investments;
- (4) imitation of resources — which offers chances for learning complex things, such as technology, market know-how, marketing procedure, etc. through collaborations; and
- (5) disposal of resources — i.e. shedding of non-core business through alliance formation.

Knowledge of motives is essential to understanding how the alliance is required to be managed and what resources can be developed and gained by the partners. Sørensen & Reve (1998) discuss two possibilities:

- (1) the partners can decide to develop assets (resources) independently of each other, combining their results at the end of the process; or
- (2) they can choose a more reciprocal mode, whereby the assets are developed jointly via innovations in turns.

In the second case, partners can either develop resources in a joint venture *outside* the alliance in question, or they engage in the continuous dialogue of developing them *within* the alliance.

By empirical study, Eisenhardt & Schoonhoven (1996) have shown that strategic alliances are driven by the logic of strategic resource needs and socially developed resource opportunities. When a firm is considering entering new markets, introducing new technology, facing many competitors, etc., the strategic position of the firm becomes vulnerable. To develop resources within the firm is often risky, costly, and time consuming, and strategic alliances are usually preferable in such situations. Furthermore, the conception of social position is relevant when a firm is well connected and has a management team that is adept at cultivating business relationships. This is a unique resource that a firm can exploit in forming collaboration with other firms. Eisenhardt and Schoonhoven combine these two resources, one dealing with needs and the other with opportunities, as a possible explanation of alliance formation. Their work has been an application to the extended resource-based theory.

In a recent study of strategic alliances, Hyder & Abraha (2001) examine the process of resource exchange in the Baltic States. They report that partners

have gained access to each others' complementary resources, and have developed their competencies in important resource areas that were lacking upon entering the alliances. This finding is in contravention to a conclusion of Tsang (1998), who maintains that successful learning will cause alliance instability. Hyder and Abraha's case may be special as it deals with partners of asymmetric strengths, i.e. firms with minimal chances of future competition between them. Furthermore, foreign firms engage alliances in the Baltic States mainly to exploit local market opportunities. This requires contributions from a partner in the market with the relevant expertise and business connections.

A longitudinal study of joint ventures by Hyder & Ghauri (2000) offers some interesting insights on resource contributions by the partners. They suggest that when a firm increases its involvement with its local partners and other actors in the environment (e.g. suppliers and distributors), the relationships are strengthened through open access to one another's resources. Extended knowledge regarding mutual competencies and interests can garner new opportunities, which may in turn lead to deeper understandings and further interesting collaborations. Similarly, an imbalance in the contribution of resources leads to diminished trust, and thus has a negative influence on the relationship. For example, in a survey of small firms in Norway, Hu & Korneliussen (1997) found that it is important for the parties to allocate appropriate resources for cultivating personal ties, as well as business ties, with each other.

## **2.5. Network Development and Strategic Alliances**

The basic logic behind network theory is that no firm is self-sufficient, and is therefore continuously involved in various relationships to accumulate resources to reach organizational objectives. According to the network perspective, the nature of relationships established between various parties will influence strategic decisions, and the network involves resource exchange among its different members (Sharma 1993). The model of industrial networks which involves exchange relationships consists of three groups of variables: (1) actors, (2) activities, and (3) resources (Håkansson & Johanson 1993; Håkansson & Snehota 1995). Actors can be organizations or even single individuals. Activity links include technical, administrative, commercial and other procedures of an organization that can be linked in various ways to those of another organization for the purpose of accumulating and/or creating resources (Håkansson & Snehota 1995; Tikkanen 1998). Johanson & Mattsson

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(1988) suggest that a firm's success in entering new international markets depends more on its position within existing market networks than on specific characteristics of the market and culture in question.

The focus here is on the relationships; those lacking given strengths can acquire them by establishing alliances with the appropriate actors. By channeling information, social networks enable firms to discover new opportunities. These networks can thus influence how often, and with whom, such firms engage alliances (Gulati 1998). However, not all relationships are of equal value; therefore, they are treated differently on a merit basis. Strategic alliances such as licensing, product development agreements, R&D agreements, joint ventures, etc. are important categories of network archetypes, and require varied degrees of involvement by the partners. Success of an alliance often depends on how well its constituents manage existing contacts and develop new ones, primarily via help from one another.

Researchers have applied the network approach to study internationalization processes and market entries (e.g. Sharma 1993; Covello & Munro 1997; Tikkanen 1998; Chetty & Blankenburg-Holm 2000; Ghauri & Holsti 1996), but only a modicum of strategic alliance studies deal with this important viewpoint. Hyder & Ghauri's (2000) work shows that involvement in joint ventures offers partners the scope to engage and develop new relationships with other parties. These contacts are particularly important when partners lack competencies, resources, etc., or desire expansion into neighboring countries. In their study of strategic alliances, Hyder & Abraha (2001) considered network issues in the theoretical framework, and observed that network development constitutes an important evaluation criterion for partners' operational success.

### **2.6. Summary**

Strategic alliances are long-term arrangements between partners to attain mutual goals. Entering new markets, developing and diffusing technologies, and gaining access to vital resources are some important reasons firms engage in alliances. Three types of alliances, i.e. non-equity, equity, and joint ventures are defined. Four theories i.e. transaction cost, resource dependence, network, and resource-based perspectives offer a theoretical explanation of alliance formation and its operation. Learning has been recognized as a central issue because partners benefit from one another's knowledge and experience, but successful learning depends on partners being willing to pursue it. That individual resources be of a mutually complementary nature is observed as a

primary issue in selecting a particular alliance partner. How resources are utilized and managed has therefore been discussed from the popular resource-based view. Finally, maintaining and developing existing networks within and outside alliances is stressed.

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## Chapter 3

# Methodological Discussion

This chapter describes the method that has been applied in writing this book. In other words, it is an illustration of the various contents of the book and the sequential phases through which the whole work is developed. A well thought-out strategy is followed, from the early stage of developing the research issues, to conducting the entire investigation (research) and drawing the conclusions. A brief discussion on how the classification of ECE is made, is introduced in this chapter. A more detailed discussion on the grouping is taken up in Chapter 4. Further, the research approach, development of the theoretical framework, and why case study is adopted as the research strategy, are discussed. Identification of cases, preparation of the questionnaire, selection of respondents and execution of interviews, validity and reliability of the study, presentation and analysis of the cases, and presentation of the results, are also thoroughly addressed in this chapter.

### 3.1. Research Strategy

#### 3.1.1. Why This Topic?

Firms operating both in the domestic and international market are creating different forms of inter-organizational cooperation. Such cooperation is necessary because the changes taking place in the market, i.e. both domestic and international, are creating many problems, uncertainties and threats for almost every firm in operation. Additional competence, resources and experience are therefore required to overcome these inconveniences, which are created by these changes. The new challenge turns out to be a difficult task for a single firm to handle on its own. Even if a firm is able to manage by itself, it becomes too risky considering the extent of resources needed to carry out the function. There is also a time factor, which can negatively affect the

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performance of a firm. Further, outcomes may not be equally successful as they could be achieved in collaboration with other firms. It is our assumption that firms perform better when they combine complementary resources, experiences and competencies rather than compete against one another. Better performance enables the concerned firms to strengthen their competitive edge. Therefore, for better and faster outcomes at a lower cost, various forms of cooperation are entered into by firms. This shows a change in the rules of play in the market, rendering even competitors willing to collaborate whenever necessary and appropriate. This does not mean that firms do not compete, but instead of competing with all other firms, they collaborate with some of them to strengthen their competitive edge and achieve better results. This shift in outlook has aroused our interest to focus on the phenomenon of strategic alliance. In sum, this entails cooperative competition or competitive cooperation, which we deal with in this study.

Even successful and profitable firms form working alliances due to two major reasons. The first of these (see Brierty *et al.* 1998) is that the cost of developing good products, as well as the sophisticated equipment and factories required to produce them, is increasing tremendously. Secondly, with the shortening of product life cycles and strengthening of foreign competition, the risks associated with such expenditure exceed the actual cost. These issues make it necessary for firms to engage in various forms of collaboration.

### ***3.1.2. Why Eastern and Central Europe?***

We have found it interesting to study strategic alliances in the ECE for several reasons.

- (1) It is generally argued that knowledge of how the markets in ECE function is scanty. This lack of knowledge raises many interesting questions, for example: how these markets are organized, how they operate, and how they affect foreign firms' attempts or operations in the form of international alliances.
- (2) There are differences between ECE countries and West European countries, as well as the firms in the two regions. The differences between firms can, among other things, be due to their varied backgrounds, organizational structures and cultures, motives, strategies, resources, and experience.

However, the differences between ECE and West European countries are those relating to economic development, infrastructure conditions, cultural

and social factors, and traditions in and manners of conducting business and negotiations. There are also differences in languages, availability of manpower, technological developments, networks and how they work, government policies and roles with respect to the economic activities of the individual countries attitudes towards foreign firms, etc. These factors may have an impact on the formation, function and development of strategic alliances. In the past, the economic structure that prevailed in the ECE merely followed the Soviet style (see Sword 1990), in which relationships between consumers and producers in the market did not exist. It was the state machinery that controlled economic management of these countries (*ibid.*). The state determined what should be produced, and the allocation of the necessary resources and setting of targets was also their duty. Because the economy was centrally planned, there was also a lack of initiative and innovation. The development of new ideas and entrepreneurship, which flourished in the West, was missing in the ECE because the appropriate incentives were absent. Things are now changing, but we assume that major gaps are still in force.

Poland, for example, initially attempted to change the overall situation through the importation of Western technology and investment. However, in the absence of appropriate structures required for success, this did not work. The various forces in the market were less significant, as everything was planned centrally. This part of the world is now shifting from a planned, to a market economy, and finds itself in the middle of the road. These current conditions can and do affect the functioning and operations of strategic alliances in a rather unique way.

- (3) The firms in focus in the study have different backgrounds and experiences at the same time as the ECE is undergoing a process of change. These factors have an impact on the strategic alliances of firms. It has been declared on various occasions that ECE economies are becoming liberalized; governmental and societal attitudes towards foreign firms are changing, offering favorable conditions. Therefore, in line with the recent changes and developments in this region, it is of interest to look at what factors are involved and how they influence the formation and operation of strategic alliances. Whether or not these factors create obstacles or opportunities, how firms handle such situations, and the results they achieve, will also be addressed.
- (4) The population of the ECE is 430 million (Quelch *et al.* 1991), which is almost equal to the West European market. As such a big market was not open for a long time, it is of added importance to investigate how Western firms explore the opportunities, particularly with the aid of collaborations.

### 3.1.3. Selection of Countries

The degree of progress towards a market economy in ECE (see, Quelch *et al.* 1991) differs from country to country. In their study of marketing management, Quelch *et al.* divided eight countries into two groups — those that are adjusting more rapidly to a market economy (Hungary, Czechoslovakia, Poland, and East Germany) and those more slow to adjust (Bulgaria, Romania, Yugoslavia, and the USSR). In practice, Poland and East Germany are being subjected to the most rapid “shock treatment” transitions. Hungary has long been the country most favorably disposed to Western investment, so companies unfamiliar with doing business in Eastern Europe can more easily get started there. However, a large foreign debt and increased inflation are slowing progress. The pace of economic progress has also been slower than expected in the former Czechoslovakia, although a well-trained workforce and strong manufacturing tradition make it attractive.

Taking the above classification into consideration, as well as the recent economic developments discussed, other economic indicators, and political as well as social changes and developments in the region, we have, for the purposes of this work, classified the Eastern and Central European (ECE) countries into three groups. This has been done because we found it necessary to include also an ‘in-between’ group of countries, i.e. a *medium adapters* group. Although we do not reject the underlying factors in categorization of the countries into two groups, in carrying out our study, we observed that some ECE countries did not fall cleanly into the fast or slow adapters group. It became clear to us that some countries were slower than the fast adapters yet faster than the slow adapters, making it necessary to update the classification to reflect these developments.

In this study, we view: Hungary, Czech Republic, Slovakia,<sup>1</sup> Poland and Slovenia as fast adapters to a market economy; Estonia, Latvia, Lithuania and Croatia as medium adapters; and Bulgaria, Romania, Albania, Macedonia, Russia (including the other Soviet republics with the exception of the Baltic states) and Serbia<sup>2</sup> as the slow adapter group. The reason for treating Russia among the slow adapter group is because the communist party in that region is gaining strength and the state has on different occasions declared its plans to repurchase the industries that have been privatized. The countries believed to be fast adapters to market economy did quite well. Since reforms have been

<sup>1</sup> Czechoslovakia is now divided into the Czech Republic and Slovakia.

<sup>2</sup> Yugoslavia is also split up into Slovenia, Croatia, Serbia, Bosnia-Herzegovina, Macedonia, Montenegro, Kosovo and Metohia.

implemented in those countries, they have tried to liberalize prices and trade, cut government subsidies, reduce inflation and sell off state enterprises. The second factor which has influenced or shaped our decision to introduce a third group, the medium adapters, is the categorization of ECE countries by Tietz (1994) into three groups, which is discussed in detail in Chapter 4.

Finally, we have tried to select a sample of countries from each of the three groups. However, it should be kept in mind that the selection of countries was also influenced by the availability of appropriate firms in those countries. A country could not be selected unless there was a strategic alliance established between a local and a West European firm. Our initial aim was to study strategic alliance in every country. In the end, however, some countries had to be excluded due to the non-existence of established strategic alliances. From the fast adapters, Hungary and Poland have been selected. From the medium adapters, we have Lithuania, Estonia and Croatia. Russia and Serbia represent the slow adapters. After collection of the data and during the analysis, we found that some countries, especially in the medium adapter group, were doing very well. This can mean that some shifting of countries from one group to another may be necessary. There has, however, been no indication that a change in the number of country groups would be essential.

### ***3.1.4. The Research Approach***

Various researchers such as Podsakoff & Dalton (1987), Yin (1994), Bryman (1988, 1995) and Tashakkori & Teddlie (1998) distinguish and discuss the differences between qualitative and quantitative research approaches. They further contend that several forms of organizational research can be described as containing or showing many of the qualities of 'quantitative and qualitative research'. In the quantitative research approach (Tashakkori & Teddlie 1998), the starting point for a study is a theory about some aspect of organizational functioning. A specific, testable hypothesis or hypotheses is/are then formulated from this theory. The essential part of the quantitative research process is the generation of data to test this hypothesis. Bryman (1995) has identified and discussed seven distinguishing characteristics of the qualitative research approach. First, there is a strong emphasis on interpretation of the data or information collected. Second, much emphasis is given to the context of the phenomenon or the study object. Third, the process, i.e. the unfolding of events in time, is emphasized in qualitative research. Fourth, the structure of qualitative research is minimal and requires flexibility. Fifth, different types of data collected from various sources are used in qualitative research. Sixth,

organizational culture is not a given but must be constructed socially and has to be maintained by those engaged in the organization. Finally, in conducting qualitative research, acquiring and maintaining close contacts to the phenomenon is necessary. Bryman (1995) has also compared these seven characteristics of qualitative research with quantitative research. Likewise, Yin (1994) discusses the differences between qualitative and quantitative research approaches and how the two approaches can be combined depending on the problem to be addressed and the purpose to be achieved.

Because the aim is neither to formulate hypothesis from the conceptual work nor to test the developed hypotheses by generating the necessary data, the quantitative approach is not appropriate in this work. By relating our research process, problem, design and purpose to the main features of qualitative and quantitative research, we have decided to pursue a qualitative approach in our study. The seven characteristic features of qualitative research have influenced our work, and their influence is reflected throughout the research process and the results achieved in this project.

This work puts strong emphasis on the interpretation of the collected information, to deepen, broaden and support our knowledge and understanding of strategic alliances. Much emphasis is given to the context (general environment) within which the phenomenon we have examined operates. Several factors in the environment which have a major impact in the functioning and process of strategic alliances were identified from the findings and are incorporated in the model and at the same time applied in the analysis of the information collected. Emphasis has been put into identifying and describing critical events in order to understand the phenomenon under consideration. The structure was also minimal in conducting cases and helped us to achieve maximum flexibility whenever necessary during the research process, which is a typical characteristic of the qualitative research approach.

### **3.2. Development of the Theoretical Framework**

Four different perspectives are combined in developing the theoretical approach applied in this work (Figure 3.1). At the very outset of this research, the authors attempted to recapitulate their knowledge and experience of the phenomenon under consideration, which constitutes the first perspective, without referring to any specific literature. Consequently, a preliminary research problem and theoretical framework were developed without review of any secondary data dealing with alliances. With the preliminarily formulated research problem and theoretical framework in mind, a literature review, which

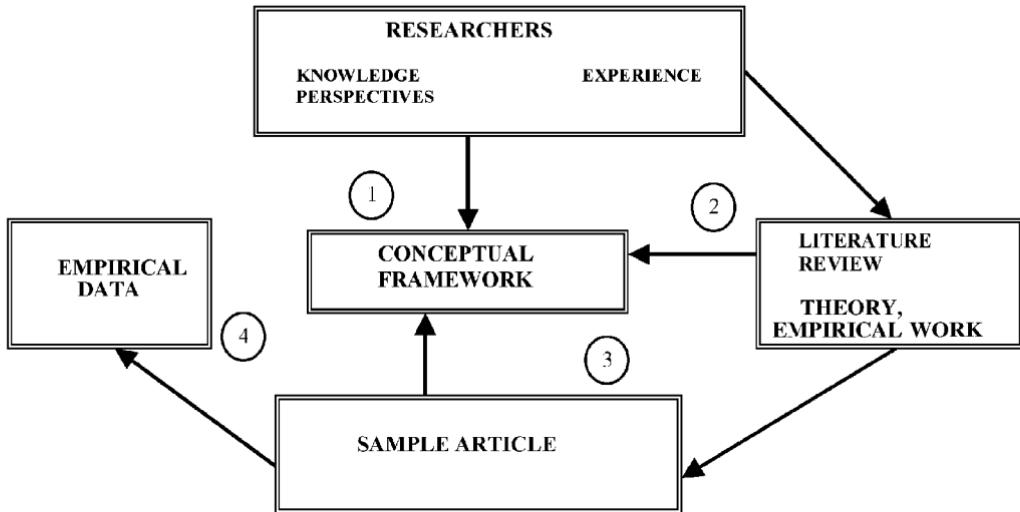


Figure 3.1: Four perspectives in interaction in developing the conceptual framework.

is our second perspective, was conducted to further develop the research problem and the conceptual framework. The authors did not adhere strictly to their preliminary work while revising the literature; instead an open-minded approach was used so that the available literature could be fully utilized. The authors did their best to adapt the preliminarily developed theoretical framework to the existing body of knowledge and develop it further in line with the existing models and concepts on the research topic ‘strategic alliances’.

Although the theoretical framework was developed further, in line with the literature review, additional concepts were not discovered. Each and every concept in the model was discussed in depth and width by taking into consideration several dimensions and variables. In addition to developing the model further, the literature review enabled the authors to gain an in-depth insight into the issues being examined. Moreover, we identified and meticulously examined theoretical frameworks that have been applied in the relevant studies. This process has helped to develop in depth and width the concepts already identified, as well as how they are related to each other and how they can be applied to examine the research problem. Further, the process has also broadened the researchers’ knowledge and understanding of the subject, which has been helpful and applicable throughout the research process.

While revising the existing body of knowledge on strategic alliances, it was observed that, in addressing the current problem, it might be helpful to apply the concept of networks in data collection, analysis and assessing the performance of the strategic alliance. A detailed discussion on networks will be taken up with respect to framework development in Chapter 5. Although, according to existing literature, the networks of actors are significant in the formation, development and functioning of strategic alliances, they were more or less neglected or given no deserving attention.

To test the validity and applicability of the model, it was applied in one study, which makes up the third perspective of the process. The model was observed to be a useful tool for collecting and analyzing the empirical data. Moreover, it helped to structure, limit, and interpret the information collected in light of the research problem and purpose of the study. After the empirical data was collected for the first article (Hyder & Abraha 1999), our earlier observation, that the concept of network was a relevant and useful aspect to be included in the theoretical approach, was further confirmed. In other words, it was clearly understood that the theoretical framework had to be enriched by developing and adding further network concepts.

Empirical data constitutes the fourth perspective in the development of the framework. After collection of the data, the model was developed further

because the authors noted that one more important variable, i.e. "General Environment" should be added. The importance of this variable was also noted during the literature review and preparation of the mentioned study. Consequently, more questions were taken up to identify which factors of the environment influenced the formation and operations of the alliance, how, and to what extent. Finally, the various environment factors observed to influence the functioning of the strategic alliances were incorporated into the model and discussed in detail.

### **3.3. Case Study as a Research Method**

The case study is an appropriate research method when a subject is complicated and involves inter-organizational relationships. Human contacts play a vital role in planning, forming and maintaining these types of relationships in working order. According to Yin (1994), a case study is an empirical inquiry that investigates a contemporary phenomenon within its real-life context when the boundaries between phenomenon and context are not clearly evident. This study is complicated for at least three reasons. Firstly, human relationships over national boundaries are in focus. Secondly, the alliances involve local partners from Eastern and Central European countries with distinct differences in social, political, entrepreneurial and cultural backgrounds in comparison to Western firms. And thirdly, the theoretical aspects of alliances are under development. A further difficulty relates to the processual approach of the study, i.e. considering relationships over time rather than at a specific point of time. Gaining an understanding of an ongoing real-world situation is only possible when all things related to the phenomenon are considered. In fact, because the purpose is not only to identify or verify certain causal links, unlike in a survey, the case study researcher not only talks in terms of variables, but is also concerned with understanding, describing and interpreting the whole situation. Case studies offer a holistic view of the phenomenon under investigation, and can offer explanations as to why certain decisions were made, how they were implemented and with what results (Chetty 1997). Considering the explorative nature of this study, we have therefore applied a qualitative case-study method here.

One main characteristic of the case study approach is that it is flexible, which is very important when describing a process. Flexibility means that the researcher need not be confined to the previously developed questions, but can complement the interview with follow-up questions to give further insight into the events and overall situation. Another type of flexibility relates to the

possibility of modifying the research design. It is not essential to design formal questions, though some guidelines are necessary to conduct the interviews in order to ensure that the study remains focused and corresponds to the research problems. These guidelines or questions should enable respondents to describe the process, as it really exists, without too much influence — so that the process becomes a natural outcome of the prevailing situation. Additional questions or thoughts can even be taken up later, not necessarily on the same interview occasion. However, a clear understanding about the unit of analysis is necessary in applying a case study method. In this study, we have one main unit of analysis, i.e. the strategic alliance itself.

In the selection of case studies, great caution must be exercised. The purpose of case selection in a study such as this is not to meet representativeness, but to ensure that the cases really do address the research questions and are in line with the main purpose of the study. This claim is even more legitimate when the purpose of the study is theory building (see Eisenhardt 1989).

### **3.4. Case Selection**

#### *3.4.1. Identification of the Swedish Firms*

This was a time-consuming and challenging process. One of the most difficult things about identifying Swedish firms was to find out which ones had strategic alliances in the ECE. Most of the authorities and firms contacted by the authors in the firms' identification process had difficulty understanding what was meant by "Strategic Alliance." This created a real problem and it took time to clarify to the concerned bodies. Not only did we have difficulty explaining to the Swedish firms what it was all about, but even after this laborious and tiring process, some of the selected companies had not strategic alliance at all in Eastern and Central Europe. Due to misunderstandings, on several occasions it was discovered — in the midst of interviews — that the firms had no such strategic alliance. Faced with these unexpected circumstances, we were then forced to begin the process of identifying firms with an appropriate form of operations functioning in ECE countries all over again. This made the search process complicated and lengthy.

The first step taken by the authors in identifying companies was to contact the Swedish Export Trade Council. One important contribution of the council was that it was able to provide us with information about what the Swedish government, and Swedish International Development Agency (SIDA) in particular, do to promote the participation of the small- and medium-sized

Swedish firms in the Baltic, Russia, Ukraine, Moldova, Georgia, Armenia, and Azerbaijan. Specifically, SIDA provides financial support to Swedish firms starting up in the Baltic States. In addition, the Swedish Export Trade Council provided a list of small Swedish firms operating in the Baltic States with the aid of the “SIDA Start East Program.” This information itself gave us a clue to how scarce and critical financial resources are in this region. The said list included Small and Medium-Sized Enterprises (SMEs) from Western Sweden operating in the Baltic. There was, however, no indication of whether they were fully-owned enterprises or operating through some form of cooperation with local companies. The authors had no choice but to contact each and every company to ask whether they had strategic alliances in the Baltic States or not. Five of the firms included in the list were found to have some sort of collaboration with local firms in one of the three Baltic States. These five firms were selected and included in the study.

As the authors were unable to proceed further with identification of firms by way of the Swedish Export Trade Council, it was necessary to contact other organizations. Consequently, the Ministry of Foreign Affairs was contacted in order to obtain the addresses of Swedish embassies in the ECE countries. Upon receipt of the addresses, 15 embassies were contacted and asked to provide a list of Swedish companies operating in their respective countries. Only seven of them responded positively and furnished us with a list of these companies. A number of these contained several hundred companies in which only the names and addresses of the firms were listed. That is, one could not see from the list whether they were fully-owned companies or engaged in collaborations. Therefore every company had to be contacted to find out which form it operated under and whether it could be included in the study. An additional three companies were identified with the help of the lists received and contacts we initiated with the firms on the basis of the information furnished. In addition to the five firms already identified, the total of firms identified as having some sort of collaboration and thus to be included in the project was now eight.

The next step taken was to contact the embassies of the Eastern and Central European countries in Stockholm to see if they could help with company identification. None of them were able to provide the information required and all of these embassies referred the authors to the Swedish Embassies in their respective countries. As the authors had already been in touch with the Swedish Embassies in the 15 ECE countries, there was no need of retracing these steps.

At this very critical stage, we contacted head office of the Export Trade Council in Stockholm with the aim of being put in touch with the council’s representatives in the ECE region. Through this, we obtained the addresses of

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these representatives in the ECE. The representatives were then contacted once again and asked to collaborate in the identification of firms with strategic alliances. This approach did not prove to be fruitful, as they were unable to furnish the lists of firms required. Instead, they produced an exhaustive list of Swedish firms operating in every country, more or less the same lists as had already been received. The contacts were however pursued by way of phone, fax and letters, but yielded no fruitful outcome. The Swedish Export Trade Council was once again contacted to provide a complete list of firms operating in the ECE. From this new list, we were finally able to identify and select another five Swedish companies, bringing the total number of firms selected up to 13.

A further source used to identify Swedish firms, was a Swedish daily business newspaper, *Dagens Industri*, which contained a list of several Swedish firms entering the ECE in collaboration with local companies. Five companies were selected from this source and an additional two companies identified spontaneously while conducting interviews with the already identified firms. The total number of Swedish firms thus reached 20.

### **3.4.2. Selection Criteria**

Before selecting firms, the following criteria were set out:

- A Swedish firm operating in the high-tech industry;
- The firm must have at least one alliance in the ECE countries;
- The alliance must have been in operation for a minimum of two years (This time limit was deemed necessary to ensure the partners' entrance into a full-fledged relationship, and also corresponds to the research questions and objectives);
- The alliance must be engaged in production.

As we succeeded in identifying only 20 Swedish firms engaged in such alliances, it became difficult to apply all the above selection criteria, leaving us with two options:

- (1) to fulfill the criteria and reduce the number of selected firms; or
- (2) maintain all the identified firms but adhere less rigorously to the set criteria.

To make the study more extensive and meaningful, we chose the second option. We were, however, able to retain the criteria concerning the requirement of at least one alliance in the ECE and having been in operation for at least two

Table 3.1: Year of establishment and industry distribution of the firms operating in the fast-adapting countries.

No.	Swedish Partner	Year of Establishment	Industry Distribution
1	Paroc Rockwool	1996	Petroleum, Metal Products and Non-Metallic Mineral Products
2	PLM	1995	Rubber, Plastic Products, and Metal Products
3	Bulten Tools SC	1997	Fabricated Metal Products
4	Nordic Ecofiber	1993	Building Materials
5	Korsnäs	1998	Pulp and Paper
6	Vattenfall	1998	Power and Electricity
7	Svedala Industries SC	1992	Basic Metal, Metal Products, Machine & Equipment and Rubber & Plastic
8	Getinge Industries SC	1990	Metal Products, Electrical Goods, Machinery & Equipment and Medical Precision & Optical Instruments

years. The names of the Swedish firms, their principal industries of operation, and the year of establishment are shown in Tables 3.1, 3.2 and 3.3, for fast-, medium- and slow-adapting countries, respectively.

### 3.5. Data Collection

#### 3.5.1. Preparation of the Questionnaire

Because most case studies deal with human affairs, this study being no exception, interviews are an essential source of case study evidence (Yin 1994).

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Table 3.2: Year of establishment and industry distribution of the firms operating in the medium-adapting countries.

No.	Swedish Partner	Year of Establishment	Industry Distribution
1	Kallefall	1995	Machinery & Equipment
2	Arvidsson	1993	Clothing, Footwear and Leather
3	DPC Skaffe	1994	Medical and Related Services Industry
4	Partec Rockwool	1995	Chemical, Metal Products and Non-Metallic Products
5	Accel SC	1993	Automobile
6	Ragn-Sells SC	1991/1992	Resource and Waste Management
7	Ericsson	1994	Telecommunications

Table 3.3: Year of establishment and industry distribution of the firms operating in the slow-adapting countries.

No.	Swedish Partner	Year of Establishment	Industry Distribution
1	Husqvarna SC	1970	Machinery & Equipment and Electrical
2	XYZ SC	1996	Machine and Basic Metal Products
3	Holmen	1994	Pulp and Paper
4	Stora	1995	Pulp and Paper, Forestry Logging and Related Activities
5	Korsnäs	1997	Pulp and Paper

To follow the research guidelines, we decided to use an unstructured questionnaire for data collection. In preparing the questionnaire, we have strictly followed the conceptual framework in Chapter 5 and the research problem of the project presented above in Chapter 1. The questionnaire was designed loosely structured and open-ended to allow the respondents to talk freely and provide a natural and complete picture of the whole process of the strategic alliance. Both the historical background and the comments and opinions of the main respondents constitute a focal part of the study. The main concepts and variables of the model are reflected in the questionnaire, which has made it possible to create a strong linkage between the research problem, the conceptual framework, and the empirical data. Another advantage of the unstructured questionnaire relates to the possibility of raising additional questions and discussing essential issues in depth.

### ***3.5.2. Selection of the Respondents***

The research problem and the prepared questionnaire were sent to the companies, who themselves selected the respondents. In the first place, the authors did not have sufficient information concerning who was responsible for the firms' operations in the ECE countries. Secondly, as the firms' engagement in those areas did not have a long history and wide coverage, there were very few people, sometimes only one person in the organization, who could provide the necessary information. Thus, the authors had little influence in selecting the interviewees. However, the choice of a suitable respondent — someone able to provide the relevant information — was stressed.

### ***3.5.3. Execution of Interviews***

In most of the cases tape recorders have been used to record the interviews. This was helpful for at least two reasons:

- (1) it minimized the chance of mistakes or misunderstandings; and
- (2) it gave us time and opportunity to concentrate on the interviews and to come up with follow-up questions whenever necessary.

The authors explained to the respondents why the recording was necessary and recording was done only after getting the consent of the interviewees. Details of the interviewees, including their names and positions, and the dates and duration of interviews are presented in Tables 3.4, 3.5 and 3.6, for fast-, medium- and slow-adapting countries, respectively.

Table 3.4: People interviewed in the firms operating in the fast-adapting countries.

No.	Swedish Company	Persons Interviewed	Position	Date of Interview	Duration of Interview
1	Paroc Rockwool	Leif Korp	Director of Business Development	30/03/2000	3 hours
2	PLM	Claes-Göran Lindvall	Vice President	25/02/2000	3 hours
3	Bulten Tools	Anders Carlsson	Vice President	24/10/1999	2 hours
4	Ecofiber	Anonymous	Managing Director	25/08/2000	2½ hours
5	Korsnäs	Göran Angesten	Manager	12/09/2000	2 hours
		Ruzdi Ekneheim	JV Manager	07/09/2000	1 hour
6	Vattenfall	Bengt Vegemo		28/03/2000	2 hours
7	Svedala	Bengt Dehlén	President Wear Protection	25/02/2000	3 hours
8	Getinge	Bodil Hammarström	Regional Sales Manager	24/02/2000	3 hours

Table 3.5: People interviewed in the firms operating in the medium-adapting countries.

No.	Swedish Company	Persons Interviewed	Position	Date of Interview	Duration of Interview
1	Kallefall	Anders Thunström, Kjell Johansson	Production Manager, Product Development Manager	05/05/1999/ 06/05/1999	3 hours 4 hours
2	Arvidsson	Uno Johansson	Production Manger	05/05/1999	2 hours
3	DPC Skafte	Harald Skafte	Managing Director	07/05/1999	3 hours
4	Partec Rockwool	Leif Korp	Director of Business Development	24/03/2000	3 hours
5	Accel SC	Sten Nilsson	Managing Director	29/10/1999	2½ hours
6	Ragn-Sells	Björn Gidö	Managing Director	21/03/2000	3 hours
7	Ericsson	Stefan Brandt	Export Manager	25/08/2000	3 hours

Table 3.6: People interviewed in the firms operating in the slow-adapting countries.

No.	Swedish Company	Persons Interviewed	Position	Date of Interview	Duration of Interview
1	Husqvarna SC	Norre Mattsson	Vice President	20/04/2000	2½ hours
2	XYZ Company	Anonymous	Marketing Manager	05/11/1999	3 hours
3	Holmen	Inge Andersson	Wood Works Director	29/08/2000	3 hours
4	Stora	Anonymous	Manager	31/08/2000	2 hours
5	Korsnäs	Göran Angesten Ruzdi Ekneheim	Manager JV Manager	12/09/2000 07/09/2000	3 hours 3 hours

The authors did their best to explain to the respondents the issues being investigated before conducting all interviews. Although it was not always easy to give a complete picture, it was important that the respondents were given background knowledge and information about the phenomena being studied. There were some questions in the questionnaire that the respondents did not answer, either due to misunderstanding or to their simply wanting to avoid answering them. In some cases, it was found that questions weren't dealt with appropriately by the respondents. The questions that were not dealt with properly, or not answered at all by the firms, were more or less the same in most cases. In particular, questions dealing with government regulations and their impact belonged to such a group. Thus, it was at times quite obvious that the information received could have been much more detailed and comprehensive than that communicated. Even if the authors were aware of this shortcoming, they had little choice other than to report the information obtained. In actuality, the questions that were omitted and those inadequately dealt with did not amount to many. Had it not been for this hesitancy shown by some of the respondents, it would have been possible to present a wide and in-depth look at the operations of Swedish firms in Central and Eastern Europe. To handle this deficiency, an attempt was made to reformulate the questions and present them again, but even this approach was not successful enough to elicit additional and comprehensive information. This was not viewed as a serious problem, but the authors would like to acknowledge the problems encountered, in the data collection in particular. There were also issues that the respondents considered sensitive and did not deal with. Here, they would give some general and indirect answers, which provided the authors with sufficient information to make their own interpretations and judgments. This discussion offers hints to future researchers on how to design research strategy for handling sensitive situations while, at the same time, giving due consideration to important issues.

Additional questions were designed to collect and to supplement the information collected and to clarify things further. This time it was easier, since the researchers already knew which firm to contact and which person to talk to, and there was already a relationship established between the researchers and the interviewees. This phase of collecting and clarifying information was mainly done through telephone interviews. The interviewees showed their readiness to give detailed information and it was clear that their initial doubts had begun to disappear.

However, despite the authors' repeated efforts to explain what the research was about, it was discovered, in the middle of some interviews, that the firm in question was not involved in a strategic alliance. In such cases, there was no

choice but to interrupt the interview and begin searching for another firm. This happened in three interviews despite prior explanations of what a strategic alliance was and how it differed from other forms of cooperation. In the three cases where this happened, the people interviewed thought that an agency relationship was the same as cooperating through a strategic alliance. As in other research works, complementary information and further clarification of some points became necessary in this project. It was found that some matters, which received vague mention, required further explanation to avoid confusion. Some ambiguities relating to the research problems, aims and data collection needed to be carefully worked out.

As discussed, some questions in the personal interviews were left unanswered or were only partially answered, as they were considered to be sensitive by the respondents. If judged necessary for the research findings, such questions were also taken up again with some rewording during the supplementary data collection and clarification stage. This time, fairly satisfactory information was acquired from most of the interviewees, enabling the researchers to fill in the gaps.

In addition to the interviews, other sources such as annual reports, interim reports, company memos, websites, booklets, and company brochures containing information about the products and services were also used as a source of additional and complementary information. In some cases, it was possible to use newspaper articles covering news of the Swedish companies, some of these even related to the alliances. This additional source of information was particularly helpful in cross-matching the material received through the interviews. Transcriptions and other written materials from the interviews were also sent to the respondents for their comments to avoid misunderstandings and to increase the reliability of the data.

## **3.6. Validity and Reliability of the Data**

### ***3.6.1. Theoretical Presentation of Reliability and Validity***

The quality of a research project and the results achieved can be measured in four ways as discussed by Yin (1994). Yin recommends that the case study investigator must maximize four aspects of the quality of any design:

- (a) construct validity;
- (b) internal validity (for explanatory or causal case studies only);
- (c) external validity; and
- (d) reliability.

*Construct validity* is establishing correct operational measures for the concepts being studied. *Internal validity* is establishing a causal relationship, whereby certain conditions are shown to lead to other conditions, as distinguished from spurious relationships. *External validity* is establishing the domain to which a study's findings can be generalized. *Reliability* is demonstrating that the operations of a study — such as the data collection procedures — can be repeated, with the same results.

The concepts of reliability and validity are also addressed in detail by Bryman (1995). Here, in our study, reliability refers to the consistency of a measure. This concept is made up of two parts, i.e. external, and internal reliability. External reliability refers to the degree to which a measure is consistent over time. The most obvious way of establishing reliability in this sense is to carry out the measurement on two different occasions and to examine the degree to which respondents' scores are consistent between the two time periods. However, internal reliability refers to the degree of internal consistency of a measure.

Validity is usually considered very important in measuring quality of case study-based research. Construct validity is central in this study as it measures the interconnectedness and operationalization of the concepts. Although not expressed, there has been an implicit objective to generalize the result which concerns external validity. But the scope of measuring external validity is very limited as the conditions in the ECE are not stable but rather can be expected to undergo a variety of changes in the near future. Internal validity was not found relevant as there was no ambition to establish causal relationships between the variables. With regard to reliability, measurement of internal consistency is not relevant, though external reliability does have some degree of importance.

### ***3.6.2. Factors Affecting Validity and Reliability of the Study***

One main and important factor is the existence of a well-developed conceptual framework, which could be applied in this work. In the absence of such a framework, the validity of the research and the achieved results could be very low. To increase the validity of this work, the authors have developed an appropriate conceptual framework, composed of clear, well-developed concepts and variables. The relationships between the variables are well-defined and clearly outlined. The concepts are chosen and developed in strict compliance to the research problem and the purpose this work intends to achieve. In collecting data, the discussion questions are formulated in such a

way as to reflect the conceptual framework and its components. Further, to observe the validity of the framework, it has been applied in a separate article.

The authors have moreover used the method of theory triangulation, which means that concepts from other theories are also incorporated in the development of the conceptual framework. These theories are related to the area of strategic alliances, joint ventures and network relationships, and also concepts involving general environment and the cultural impact on the phenomena being examined. Careful combination of the various concepts and theories has been helpful in developing the applied conceptual framework. All of these measures have contributed to maintain a high construct validity of the study.

Various measures are considered to ensure the reliability of this investigation. First, the interviewees were asked to listen and check the information recorded during the interviews. Second, the transcribed information was sent to the interviewees to check whether they had been misquoted or misunderstood. This material was sent a few months after the actual period of interviews. Reviewing the material at two points in time served two important purposes: (1) it performed a double check, and (2) it provided an opportunity to compare information given in two periods which reconfirmed the accuracy of the data. The third measure was thorough documentation of the entire research process from formulation of the research problem to presentation of the results, enabling the whole process to be repeated in other studies to obtain similar kinds of results. Lastly, a separate database has also been created so that others are able to go back to the original material and find support for the claims made in this study.

### **3.7. Case Presentation and Analysis**

The twenty case studies are divided into three groups, according to the countries they operate in, and are presented thereafter in three consecutive chapters. The first of these, Chapter 6, presents the eight firms that have established strategic alliances in the fast-adapter countries Poland and Hungary. These cases include Paroc Rockwool, PLM, Bulten Tools, Ecofiber, Korsnäs and Vattenfall in Poland, and Svedala and Getinge in Hungary. Thereafter, come the seven cases on alliances in the medium-adapter countries, i.e. Lithuania, Estonia and Croatia. This chapter, Chapter 7, presents the cases of Kallefall, Arvidsson, DPC Skaffe, Partec Rockwool, Accel, Ragn-Sells and Ericsson. The final one of these chapters, Chapter 8, presents the cases on strategic alliances in the slow-adapter countries, comprising five alliances in

Russia and Yugoslavia (Serbia). The names of the Swedish and local partners for the three groups of countries are shown separately in Tables 3.7, 3.8 and 3.9.

All cases are presented by strictly following the structure of the theoretical framework (Chapter 5) to make understanding for the readers and analysis and interpretation for the authors easier. The data is presented and discussed under headings that correspond to the various concepts and variables of the framework. The main concepts in the model are used as the basis for discussion and analysis of the alliances operating in the three groups of countries. That is, when "Motives" are taken up, the motives of all three groups of firms operating in the fast-, medium- and slow-adapting countries — are analyzed. This also applies to other main variables, i.e. Resources, Learning, Network, Performance and General Environment. The analysis and interpretation of the empirical data under each variable of the theoretical framework is followed by a summary which is mainly based on the observations of the authors.

One point that should be made clear is that no separate and complete analysis of individual case studies is presented. Instead, the concepts of the model are

Table 3.7: Swedish firms and their strategic alliance partners in the fast-adapting countries.

No.	Swedish Partner	Local Partner	Country of Operations
1	Paroc Rockwool	NEFCO, FINFUND, IFC	Poland
2	PLM	Voivoda	Poland
3	Bulten Tools SC	National Investment Fund	Poland
4	Nordic Ecofiber	Poly Technique Institute and some local people	Poland
5	Korsnäs	Smurfit	Poland
6	Vattenfall	Ostrowski Energy Utility, Utska Energy Utility and Electrocieplownie Warszawskie SA	Poland
7	Svedala	Taurus	Hungary
8	Getinge	HG Medical Instruments Ltd.	Hungary

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Table 3.8: Swedish firms and their strategic alliance partners in the medium-adapting countries.

No.	Swedish Partner	Local Partner	Country of Operations
1	Kallefall	Neris	Lithuania
2	Arvidsson	Nikkinen Mentu Aktieselts	Lithuania
3	DPC Skaffe	Diagnosta	Lithuania
4	Partec Rockwool	Industry Capital Investment Co.	Lithuania
5	Accel SC	TERRA SC	Lithuania
6	Ragn-Sells	Estonian Government	Estonia
7	Ericsson	Nicola Tesla	Croatia

taken up individually, and the information presented in the twenty case studies that deals with a concept is analyzed according to country group, and summarized in the form of a preliminary conclusion. This means that the analysis contains six main sections, with the analysis of each concept separated into the three groups of firms operating in the three groups of countries. The presentation of the discussion, analysis and summary of motives, resources, learning, network development, performance and general environment is divided into three sections, i.e. according to fast-, medium- and slow-adapter group.

Table 3.9: Swedish firms and their strategic alliance partners in the slow-adapting group of countries.

No.	Swedish Partner	Local Partner	Country of Operations
1	Husqvarna Sc	TSNIME	Russia
2	XYZ SC	ABC SC	Russia
3	Holmen	YND	Russia
4	Stora	Balt Invest	Russia
5	Korsnäs	A Bank and a Local Co.	Yugoslavia (Serbia)

### 3.8. Presentation of the Results

The results of the study are presented in Chapters 10 and 11. In Chapter 10, the emphasis is on identifying and discussing the research findings by relating them to the relevant studies in the field, as summarized and discussed in Chapter 2. One important objective here was to see whether the results agree with the existing body of knowledge in the literature. Where our results deviate markedly from the existing literature we have offered explanations. Another aim was to generate new thoughts and ideas by making a comparison between the literature and outcomes of the underlying study.

Chapter 11 addresses the research issues which were raised in Chapter 1. Each research issue is discussed separately in relation to the achieved result. This measure helps to check whether all research questions have received a response and with what outcome. The results found were also compared to the theoretical explanations of alliances presented in Chapter 2. The purpose of this was to observe whether the results of this empirical study provide some evidence to the theoretical explanations. In other words, the aim was to understand the applicability of those theories in studying strategic alliances in the ECE and other similar environments. This is followed by a detailed discussion of our theoretical framework to determine how suitable it was in our study. It was to a large extent found satisfactory while some modification of the framework has also been suggested. Based on the results of the study, a list of future research issues and implications to managers are outlined.

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## Chapter 4

# Eastern and Central Europe (ECE)

### 4.1. General Overview

The total population of Eastern and Central Europe is around 350 million, which is roughly the same as Western Europe. Most ECE countries are small, with Russia being the glaring exception, encompassing around 40% of ECE's population. While admittedly crude, projections based on standard growth regressions suggest that it will take around 20 years for the faster reformers to reach present OECD per-capita income levels (Fischer *et al.* 1997).

Without doubt, ECE offers foreign companies excellent investment opportunities, and this has been amply demonstrated by the accelerating trend of capital inflow into these countries in the 1990s. Some received a major part of their investment due in no small part to the presence of political and economical stability; however, there are many attendant difficulties which hinder the flow of foreign investment into the region, despite the fact that foreign multinationals are in dire need of investment for cost reduction and market expansion purposes. Kraljic (1990) identifies the following ten types of gaps that exist between Eastern and Western countries:

- (1) Technology gap — concerns efficiency and technological improvements;
- (2) Productivity gap — at least 30% to 50% below Western levels;
- (3) Marketing gap — concerns marketing concepts and practice;
- (4) Capital gap — involves investment capacity and profitability;
- (5) Environment gap — involves environmental consciousness;
- (6) Infrastructure gap — concerns transport and communication networks and services;
- (7) Motivation gap — involves private initiative and willingness to take responsibility;
- (8) Management gap — concerns leadership ability and competence among managers;
- (9) Legislative gap — involves constitutional and legal issues;

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(10) Democratic gap — involves political leadership and the exercise of power.

Zloch Christy (1994) studied economic reforms in ECE and consider that the following changes are required during the transition period:

- (1) Market clearing prices;
- (2) Elimination of both direct and indirect state subsidies;
- (3) Import liberalization;
- (4) Unified exchange rates and current account denominational homogeneity.

Investment in ECE is a long-term process that will test the creativity and staying power of corporations and governments in Western Europe, Japan and North America (Jain & Tucker 1994). However, Western Europe will benefit more than other developed areas due to their close proximity to, and previously developed business contacts in the ECE countries. Patience is very important at this stage; the 1990s have been consumed by adaptation to Western management and marketing practices, and it is very likely that foreign firms will still have to wait to attain comfortable returns from their investments in ECE. It has become more necessary to observe the region's development carefully, and to learn how to deal with the changing environment there. ECE affords problems as big as its opportunities, so ventures therefore demand commitment, patience and flexibility (Jain & Tucker 1994). In the following sections, major environmental factors are outlined to assist in understanding ECE and the business mechanisms therein.

## **4.2. Social and Political Situation**

Although ECE governments have declared the evolution from planned to market economies a goal — and have indeed taken various measures to these ends such as privatization, adapting laws and regulations in favor of foreign investment and decentralization — they have yet a long way to go. The populace of the region has long operated under a system totally opposite to what has been practiced in the west. For many ECE countries, political power is still wielded by individuals intrinsically opposed to the reformation. Not surprisingly, there is a strong correlation between political liberalization and economic transformation in this region (Zloch-Christy 1994). Tietz (1994) identified the following problems common to all ECE countries:

- (1) Major lack of sound infrastructure;
- (2) Serious environmental pollution;

- (3) Serious supply problems;
- (4) Major currency problems;
- (5) High and increasing budget deficits;
- (6) Generally high rates of subsidy;
- (7) High budget-financed investments;
- (8) Recession entailed by restructuring;
- (9) High inflation rates (in most but not all cases);
- (10) Significant pent-up demands that cannot be met (in some cases).

### 4.3. Cultural Issues

Scholars have argued that the slow pace of Western investment in ECE may be caused by two early-stage barriers:

- (1) cultural influences; and
- (2) high international risks (Brouthers *et al* 1998).

In this section, we concentrate on the cultural issues, as internationalization requires penetration through different cultural values, norms, ways of thinking, and procedures. They have a particularly great impact on firms doing business in both the ECE and Western Europe, due to the fundamental differences between these two regions.

National and organizational cultures have been seen as distinct areas of interest and importance in business. Recently, famous cultural researchers like Hofstede (1997) and Tromprenaars & Hampden-Turner (1999) have stressed their differences in understanding human beings and their activities. This distinction is very important in the cultural context of ECE countries. Due to the longstanding communist political ideology, ECE did not allow private ownership. Every matter of economic character had fallen under the purview of a central planning authority, state ownership of business properties had been the norm, and decision-making processes were exceptionally slow and bureaucratic. The pattern of execution and operation of business enterprises, i.e. the organizational culture, was therefore quite homogeneous among ECE countries, but the national cultures naturally remained different from one another since the people had different backgrounds, languages, ethnicities, etc.

Perlaki (1994) suggests that the organizational cultures in ECE are characterized by the following traits:

- (1) highly centralized and strictly hierarchical structures;

- (2) aversions to uncertainty;
- (3) preferences for formality and standardization; and
- (4) strong collectivist attitudes.

Centralization of power and top-level decision making has been a result of the communist economic paradigm, into which the people had become indoctrinated during the post-WWII era. Many so-called ‘socialist’ values, especially in the countries of the former Soviet Union, have deep historical roots (Holtbrügge & Welge 1998). These have left marks in the people’s cognitive and emotional mindsets, thus rendering the conveyance of new values, attitudes, and behavioral patterns (by means of training and personnel development) considerably difficult (*ibid.*). Collectivism (see Hofstede 1991) is a fundamental characteristic of ECE that concerns mutual trust very deeply, so unless this trust is actively developed by a firm engaging an ECE alliance, success is unlikely. With a few exceptions, people in Western Europe are generally individualists, where professionalism in business is a vital addition to mere trust development. Brouthers *et al.* (1998) argue, with the support of other researchers, that ECE cultural attitudes tend to result in the following:

- (1) ethical standards that differ substantially from those found in Western nations;
- (2) a lack of a Western consumer/marketing orientation; and
- (3) a low level of faith in authority.

#### **4.4. Economic Development**

Since their liberation from communism, major political and economical changes have occurred in the ECE countries. These changes have also had considerable impacts on international business, and the driving forces have been technology and business rather than ideology and geopolitics (BusinessWeek 1999, Europe: *Ten Years after the Wall*, November 8). Business people, artists, local officials, and entrepreneurs have overtaken national politicians as the continent’s key decision makers (*ibid.*). However, the process of transition, while not yet completed, has not been an easy one. All the countries in ECE experienced a major decline in GDP after the fall of the Berlin wall because this changed the game rules in the whole region as a new economic era began. Most of the countries have yet to recover GDP outputs equal or above the levels of 1989. The situation of Russia and Ukraine has been worst among the selected countries (see Estrin & Meyer 1998). Russia’s growth fell drastically due to an export decline when many previously communist

countries declared adoption of market economies, thus taking their demands for imports and support to the West. Between 1990 and 1995, the systematic transformation of ECE economies was accompanied initially by a drastic and sustained fall in income and living standards, and was followed by the rapid rise of mass unemployment (Nuti 1995).

#### **4.5. Privatization**

Due to the immense interest of ECE in adopting the market economy archetype, privatization became one of the fundamental requirements in the development process immediately after communism's fall. Foreign investors were more interested in doing business with private parties than sclerotic state-owned companies. Even international donors stressed the need for privatization to speed up ECE's transition; however, experiences with privatization in ECE differ from the West by the scope of the task, the absence of efficient capital markets, and the lack of domestic private savings available for investment (Estrin & Meyer 1998). To overcome local financial problems, local alliance partners' contributions in forming joint ventures have usually been restricted to real estate.

Estrin (1994) argues that the objectives of privatization are both economic and political. The political motives are to generate popular support for the reform process, and to create a situation that renders reversion to the previous system impossible, even if the government changes. The prime economic motive is to increase production efficiency by breaking the links between commerce and the state, as well as by making managers subject to capital market disciplines. The privatization process has been time-consuming; however, the countries where it has been most successful have attracted a substantial share of ECE's capital inflows. The telecommunications sector in particular has been a priority draw for foreign capital (EBRD 1996).

Anthony Clothier (1997), a British consultant, has worked nine years on the practical details of restitution, restructuring and privatization of businesses in ECE. His conclusion is that a Western European privatization system does not function well as a cut-and-paste privatization model in ECE, especially in medium-scale industries. A major mistake by Western firms has been the assumption that working methods in their home countries will also work elsewhere, but an effective privatization policy must stem from the particular conditions, obstacles, and opportunities of these countries if it is to be successful. Clothier has listed three reasons why privatization in general has not proceeded as anticipated in ECE:

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- (1) There has been a natural reluctance to sell many of a country's most profitable or prestigious industrial and commercial enterprises to foreign investors. In some cases there has been nationalistic antipathy for such;
- (2) Foreign investors have been loath to work with ECE companies that are in dire need of reorganization, restructuring, or downsizing. Many lack focus, engage in diffuse activities, and coddle erstwhile customers;
- (3) There has been a chronic shortage of working capital in most businesses in most countries.

Countries such as Poland, Hungary and the Czech Republic proceeded slowly with privatization due to bureaucratic complexities, but this has proven advantageous because these countries were thus able to develop gradually a solid business infrastructure base and lucid privatization-encouragement policies. Goldman (1999), who studied privatization in Poland and Russia, noticed a huge rate of Russian privatization in the middle of the 1990s. As there was no efficient organization to handle the complex process, many Russian state businesses were acquired by owners that were unable to manage them properly under Western management archetypes. Finally, due to inefficient management of business activity and privatization, Russia experienced an economic shock in August 1998. What the experience in Russia shows is that the premature exercise of property rights can be counterproductive; they can undermine and discredit the whole reform effort (*ibid*). Poland, on the other hand, took the time to overcome bureaucratic hurdles and to develop a workable and efficient privatization program, and this has had a great impact on her future development.

### **4.6. Foreign Direct Investment (FDI)**

It is a well-known fact that ECE countries have historically had comparatively less hard currency to make industrial investments. Increased rates of barter trade were a direct consequence of this shortage of transferable currency. Besides political difficulties, ECE firms also had financial difficulties gaining access to modern technologies because most of these were owned by Western companies. The growth in South East Asia during the 1980s is largely believed to be the result of huge direct investments made by Western companies. After the fall of communism in 1989, it became natural for the ECE countries to seek foreign investment to speed up the process of transformation from state-owned to market economies. Although the rate of investment in ECE has gradually increased over time, the volume is unevenly distributed among the constituent countries. In the early years, Hungary alone received more than half of ECE's

invested capital, but the situation had changed by the mid-1990s, as countries like Poland and the Czech Republic started to receive substantial parts of this FDI (Estrin & Meyer 1998).

However, Fahy *et al.* (1998) raise a few questions in their discussion of the high level of foreign direct investment in ECE. First, the “first mover” advantage drew many foreign firms to grasp potential opportunities there hastily. Second, there have been no guarantees that expectations will be realized. Finally, to the ends of attaining the economic and social goals of the host country, local governments have developed needs to understand foreign firms and their goals. First mover advantage can help, for example, to acquire a dominant local firm or to gain access to important networks (Estrin & Meyer 1998), but in some cases — Russia is a good example — it can be a costly mistake when insufficient market research has been conducted. Many firms that entered Russia early had to close their operations due to unforeseen political and social problems; therefore, for a long time firms entering ECE avoided Russia (see Jenkinson 1999). The investment climate in Russia seemed to change for the first time after the defaults of 1998. There are signs that both local and foreign investments will increase due to stimulation by the so-called “Putin effect” and high prices of crude oil in the world market in 2000 (Dagens Industri September 22, 2000). However, these positive indicators are very new; it is too early to say how long this trend will hold, and what effect it will have on vast Russia.

Marinov & Marinova (1999) identify some common patterns of FDI in the ECE region:

- (1) FDI inflows are higher in countries that are more advanced in their transition process;
- (2) Host government attitudes have largely influenced the mode of entry and timing of FDI;
- (3) The bulk of FDI has come from neighboring countries or those with historical, cultural and business links with ECE countries;
- (4) FDI has often been motivated by opportunities to gain a first-mover advantage in ECE markets.

## 4.7. A Grouping of ECE

Using the parameters of population, economic strength, degree of economic liberalization, and general xenophobic temperaments, Tietz (1994) has divided Eastern and Central Europe in three groups (Figure 4.1).

<b>Top Group</b>	<b>Middle Group</b>	<b>Bottom Group</b>
Czech Republic	Poland	Romania
Slovakia	Bulgaria	Albania
Hungary	Former USSR	

Figure 4.1: Classification of eastern and central Europe adopted from Tietz (1994).

Tietz recommends that Yugoslavia's fragmentation into various republics needs to be considered separately, due to their involvements in the civil war there during the 1990s. The above grouping can be a good starting point, but requires adjustments considering the latest economical and political changes in ECE. Tietz's grouping was based mainly on analysis from the early 1990s, when transformation processes toward market economies had just been launched. The situation has since changed, and the rate of success in attracting FDI has been different among ECE countries. After the fall of communism, the whole ECE area faced setbacks in income, growth, and employment; however, some countries succeeded in turning the trend, and are now gradually improving their FDI situations. German investment is a good example since Germany has historically had many various contacts with Eastern and Central Europe, not least because the formerly communist East Germany has now been reabsorbed into the republic. The ECE region experienced a spectacular growth of German foreign investment during the 1990s, increasing its average share from 0.1% during 1983–1989 to 7.4% during 1990–1996 (Tüselmann 1999 and Table 4.1), but the lion's share went to the advanced reform countries, namely the Czech Republic, Hungary and Poland. Tüselmann found that although the combined population of these countries constitutes only 15% of the ECE total, they attracted over 90% of German direct investment in ECE. By contrast, Russia, which accounts for about 40% of ECE's total population, received less than 3% of German investment in the ECE.

BusinessWeek (*Central Europe's New Consumers* May 25, 1998) recognizes the Czech Republic, Hungary and Poland as the leading economies in the region, and acknowledges that the citizens look to capitalize on newfound wealth. In 1997, car sales in Poland increased by 30%; this indicates that local purchasing power for costly consumer goods is growing rapidly there. Tietz (1994) writes: "As far as can be ascertained at present, Poland, the former Czechoslovakia, and Hungary have opted for the first scenario that swiftly

Table 4.1: German direct foreign investment in eastern and central Europe.

	<b>Outflows as % of all German DFI 1990/1996<sup>a</sup></b>	<b>Distribution of German DFI in ECE 1990/1996</b>	<b>No. of affiliates established/acquired by German companies 1990/1996</b>
Eastern and Central Europe	7.4	100	2,296
- Poland	1.7	23.8	574
- Hungary	2.5	34.2	588
- Czech Republic	2.3	32.4	686
- Russia	0.2	2.8	133

<sup>a</sup> Average annual share

Sources: author's calculations based on: Deutsche Bundesbank, Kapitalverpflechtung mit dem Ausland, May 1998

Adopted from Tüselmann, H-J. (1999). *European Business Review*, 99(6), 359–367

turned to a market economy". Advanced countries like the Czech Republic, Hungary, and Poland are clearly far ahead of most other ECE countries; however, considering steady growth and successful privatization and adaptation to the market economy, the Slovak Republic and Slovenia (a part of the former Yugoslav federation) also behoove recognition. These five countries are at the vanguard of ECE countries vying for membership in the European Union, and together constitute the *Fast Adapters* group in the region.

There is severe competition in ECE to attract more foreign investment, thereby ensuring faster development of the country. The Baltic state of Estonia, reduced to obscurity in the massive Soviet Union, is presently demonstrating its own potential to grow and to attract capital inflows. Poland, Hungary, the Czech Republic, Slovenia, and Estonia expect to join the EU as early as 2003 (*BusinessWeek, Central Europe: How Far, How Fast?*, November 8, 1999). These five countries have privatized large swathes of their economies, knocked state finances into shape, freed prices, deregulated markets, and curbed inflation. Estonia is the leading country among the Baltic States, and has succeeded in mobilizing valuable financial support and technical assistance from Scandinavia, mainly Sweden and Finland. The Baltic States had historical relationships with Scandinavia until their annexation into the Soviet Union. The other two Baltic states, namely Latvia and Lithuania, are also growing, but are well behind Estonia's performance (see Table 4.2 for the distribution of FDI in selected ECE countries). Among the former Yugoslav federation, Croatia has become quite stable politically, and the economy is improving markedly. The country has also shown its keen interest to adapt rapidly to the market economy. Therefore, Baltic States and Croatia, being but one step behind the *Fast Adapters*, form the second category of ECE countries, i.e. *Medium Adapters*.

Political instability is a major issue in most countries of the former Soviet Union; however, despite the return to power of reform-communist parties in several countries, Central Europe appears homogenously committed to the transition path (Estrin & Meyer 1999). Tüselmann (1999) recognizes Russia, Romania, and Bulgaria as the most politically unstable countries, with the slowest progress in reform processes. Although these countries account for over 80% of the population in ECE, they received less than 10% of the German FDI that went to ECE during the 1990s. Jenkinson (1999) portrays the situation in Russia in the following way: "... most companies with an eye on the east tend to avoid Russia, citing an uncertain political climate and overwhelming bureaucratic hurdles." Serbia is another country that had been involved in many ethnic wars with its neighbors, and has recently been the object of NATO aggression. This dominant former republic of Yugoslavia has suffered severe

political and economical crises in the 1990s. In light of shortcomings in economic growth, adaptation to market economies, FDI, privatization success, and political stability, a final third group, *Slow Adapters*, is constructed consisting of Russia, other former Soviet republics (minus the Baltic states), Serbia, and the remaining ECE economies. These groupings of ECE are shown in Figure 4.2.

## 4.8. Short Description of the Case Countries

In this section, country specific issues including FDI, management, privatization, economic growth, and adoption of market economy are addressed. Note that only those countries represented in the case studies are considered here (e.g. Latvia and others are excluded).

Table 4.2: Measures of DFI\* in eastern Europe and Russia.

Country	Cumulative DFI 1989–1996, Million U.S.\$	DFI per Capita in U.S.\$	DFI as % of GDP
Bulgaria	500	10	0.4
Czech Republic	7,100	130	3.7
Hungary	13,400	259	6.5
Poland	11,000	63	2.6
Romania	1,600	13	0.9
Slovakia	1,000	37	1.6
Slovenia	750	70	0.6
Estonia	750	128	4.2
Latvia	650	59	0.5
Lithuania	225	12	0.4
Russia		8	0.3

\* DFI per capita and as% of GDP are three year averages, 1993–1995 to eliminate effects of annual fluctuation. Sources: DFI data from IMF; 1996 estimates from the EBRD; population and GDP from World Development Report 1996.

Adopted from Estrin, S., & Meyer, K. E. (1998). *Thunderbird International Business Review*, 40(3), 209–234

<b>Fast Adapters</b>	<b>Medium Adapters</b>	<b>Slow Adapters</b>
Czech Republic	Estonia	Russia and other Soviet Republics
Slovak Republic	Latvia	(except Baltic states)
Hungary	Lithuania	Yugoslavia
Slovenia	Croatia	Bulgaria
Poland		Romania
		Albania
		Macedonia

Figure 4.2: New classification of eastern and central European countries.

#### **4.8.1. Czech Republic**

Since 1993, Czechoslovakia has been divided into two independent states: the Czech and Slovak republics. In 1948 the Communist Party seized total control of the state and established a communist regime based on the Soviet model. From 1948 to 1989 — excluding the ‘Prague Spring’ of 1968–1969 — Czechoslovakia was one of the closest emulators of the Soviet model. Central planning was introduced; priority was given to heavy industry; the industrial landscape became dominated by large conglomerates; and private ownership of the means of production was virtually eliminated. By 1952, 98% of the country’s industrial assets had been nationalized (Clark & Soulsby 1999).

Unlike the majority of ECE countries, the Czech Republic is able to boast industrial and capitalist traditions going back to the middle of the nineteenth century. Three main strands may be identified in this tradition: autocracy, a technical bias, and paternalism. Czech industrialists and their managers typically preferred autocratic policies; however, this was balanced by a concern for the welfare of the company’s employees. Furthermore, technical knowledge and skills were regarded as a necessary foundation for managers as well as workers (Edwards & Lawrence 2000). Following the collapse of communism, the country could therefore attract a large proportion of available foreign capital, and successfully established steady growth patterns. In a *BusinessWeek* article of May 25, 1998, the following comment is made:

“Although they earn only a fraction of the wages of their counterparts in Western Europe, half of the Czechs consider themselves middle class, according to a recent poll.”

The overall success of privatization and development has made the Czech Republic one of ECE's most promising candidates for European Union membership.

#### **4.8.2. Hungary**

Hungary has been another of the post-communist transformation success stories in ECE (Edwards & Lawrence 2000). Hungary led the region in implementation of the privatization process (Estrin & Meyer 1998), offered various incentives to foreign investors very early, and has been substantially more successful in attracting FDI than other Central and Eastern European countries (Business Eastern Europe 1992; Hare 1993). Several factors explain why Hungary has been able to become the leading recipient of foreign investment (Fahy *et al.* 1998):

- (a) success with and quick transformation to a market economy;
- (b) government policies favorable to business;
- (c) substantial growth of private sector contributions to GDP; and
- (d) an entrepreneurial atmosphere that Westerners find familiar and adherent to their requirements. Also, Hungary did not discriminate between foreign and domestic buyers in the privatization process, (de Kort 1999).

Economic transformations in Hungary during the 1990s have resulted in substantial organizational diversity, as a result of the interaction of companies' desire to survive in (and adapt to) the new market environment, whilst simultaneously retaining aspects of their socialist identity (Gyekiczy & Haferkemper 1996). This diversity has been intensified by the upsurge of new firms, the entry of numerous foreign investors, and the presence of managers imbued with ideologies conducive to the new methods (*ibid.*). Not surprisingly, compared to the majority of other ECE countries, Hungary has developed a strongly entrepreneurial business culture. This ethos has also drawn on the legacy of the communist experiments in privatization (marketization) and autonomous enterprise, and found a resonance in Hungarian's propensity to individualism (Edwards & Lawrence 2000). The overall Hungarian policy has had an impact on the region and other countries which are likely to follow in the Hungarian footsteps by allowing and encouraging foreign firms to make investments.

#### **4.8.3. Poland**

After Russia, Poland is the largest country in the group of ECE countries considered, with a population of 39 million in 1999. The communist government in Poland came to an end after the successful 1989 democratic election, and a concrete program of transition to a market economy had already begun in 1990 (Buckley & Ghauri 1994). Western banks and investors gained faith in this process as the 'Solidarity' movement for democracy and liberalization gained sufficient support from the Polish people. There has since been steady growth in the country; since 1992, Poland's GDP has grown by an average rate of 6% per year, making it one of the most robust economies in all of Europe (Interfax 1998; Goldman 1999). Total consumption of Western products in the country has increased substantially in recent years. Indeed, car sales in Poland increased by 30% in 1997 alone (BusinessWeek, *Central Europe's New Consumers* May 25, 1998). Large car companies quickly set up assembly plants in Poland; however, due to the country's liberal policy towards car imports from the EU, many are now considering closing them.

Much to the liking of the EU, Poland's government has taken a stand to increase trade and investment with Western countries, and to facilitate maximally its own future membership. Poland has pursued privatization vigorously, but has remained vigilant to avoid making major mistakes in its implementation. Compared to other successful ECE economies, Poland has a higher rate of government ownership of business enterprises; proportions in the Czech Republic, Hungary, and Poland are 64.4%, 42%, and 32% respectively (Aybar *et al.* 2000). Edwards & Lawrence (2000) argue that management in today's Poland displays a diversity of forms, with old and new practices co-existing. However, they note that the development of Polish management since 1989 has been strongly influenced by the American model. Many Polish managers have either studied in the United States, or have studied for American-style MBAs in Poland.

#### **4.8.4. Croatia**

After more than 45 years of membership in the Yugoslav federation, Croatia once again became a sovereign country on June 25, 1991. For several years following independence, the country was engaged in an ethnic war with Yugoslavia, during which she experienced a long period of political instability and rapid deterioration of the economy. The republic of Croatia is situated in South-eastern Europe and has a long western coastline on the Adriatic Sea. It

is bordered to the north-west by Slovenia, to the north-east by Hungary and to the east by Serbia. Croatia has a population of 4.4 million and encompasses an area of 57,000 square kilometers. Consumer prices increased by an average rate of 124.7% per year between 1990 and 1998; however, the average rate of inflation was just 6.4% in 1998, and only 3.5% in 1999. At the end of 1999, unemployment was estimated at 20.2% of the labor force.

Economic restructuring in Croatia has been held back by military conflicts. Most recently, the conflict in Serbia during the spring of 1999 had adverse affects on Croatia's economy, particularly trade and tourism, and impeded efforts to attract foreign investment. Despite the acceleration of the privatization process in an attempt to increase budgetary revenue, industrial production declined by about 2% in 1999 (European Report 2000). Although Croatia undertook major steps with privatization, the process has moved slowly, possibly due to greater intrusive control by the government. One reason for this was the Croatian government's desire to use the proceeds from the sale of state enterprises to finance unemployment benefits and reconstruction (Bartlett & Bateman 1997). However, Croatia is strongly oriented toward West European values and affiliations, and is regarded as a possible candidate for a second wave of EU aspirants, provided that it succeeds in establishing democratic institutions acceptable to existing EU members (Edwards & Lawrence 2000).

#### **4.8.5. Estonia**

Following only 21 years of independence after the fall of the Tsarist Russian Empire, Estonia was annexed by the Soviet Union in 1940, and remained under the communist yoke until 1991. It is the smallest of the Baltic States (namely Estonia, Latvia, and Lithuania), with a population of just 1.6 million people, but among them, Estonia has taken a leading position in economic development and foreign capital attraction. Regarding possible European Union membership, Estonia is frequently cited as one of the foremost ECE countries. Greek president Konstantinos Stephanopoulos said on a state visit to Estonia, that, in the opinion of Greece, Estonia should be one of the first to join the European Union in the then upcoming round of enlargement (European Report 2000).

Estonia has been very active internationally, and has requested international economic assistance in various policy areas (Buckley & Ghauri 1994), and the country's stability has fostered a healthy business environment (Business Eastern Europe June 5, 2000). Being on its periphery, Estonia's historically Western ethos was not entirely destroyed by absorption into the USSR; the educational standards of Baltic peoples are generally higher, and the

knowledge of foreign languages (especially English, German, and Swedish) is greater. Estonia's earlier dependence on Russia for external trade has ebbed markedly over the years. Her major exports now go to Finland and Sweden, which together account for almost half of Estonia's FDI receipts, and wholly one third of imported goods come from Finland. Estonia also took swift measures to privatize state owned companies to ensure managerial efficiency and economic development; Cited in Edwards & Lawrence (2000), a report of Price Waterhouse Cooper (1998) comments on the Estonian economy:

“Estonian privatization has now entered its final phase, with only large-scale infrastructure companies left to be sold.”

#### **4.8.6. Lithuania**

The Republic of Lithuania (formerly the Lithuanian Soviet Socialist Republic) is situated on the eastern coast of the Baltic Sea, in northeastern Europe. It is bounded by Latvia to the north, by Belarus to the south-east, by Poland to the south-west and by the territory of Russian Federation to the west. According to World Bank estimates in 1997, Lithuania's GNP was \$8.360 billion; equivalent to \$2,260 per capita (measured at average 1995–1997 prices). The manufacturing sector accounted for 18% of GDP in 1999, and engaged 18.4% of the employed labor force in 1997. Russia was the principal source of imports in 1999 at 20.1%, and Germany was the main market for exports at 16.0% (European Report 2000).

During the early 1990s, Lithuania's government embarked on a comprehensive program of market-oriented reforms, including transfer of state-owned enterprises to private ownership and adoption of measures to encourage foreign investment. However, increases in fuel prices and the disruption of trading relations with countries of the former U.S.S.R have led to a severe decline in industrial productivity, and a concomitant deterioration in living standards. By the mid-1990s, the government's stabilization program had achieved many modest successes:

- (1) development of the private sector, initially through a voucher privatization scheme, was well advanced;
- (2) most prices were liberalized;
- (3) reform of the legal system had been introduced; and
- (4) some progress was achieved in financial sector restructuring.

Nevertheless, the economy contracted in 1999, with real GDP declining by an estimated 4.1%, due in large part to Russia's economic crisis one year

previously. Another principal consequence of this was a depression of Lithuanian exports, causing the trade deficit to widen (European Report 2000). However, the privatization process has been quite effective and rapid; already by April 1991, there were 7,518 private farms and over 5,000 cooperatives in the agricultural sector (Buckley & Gahuri 1994). Plans for European Union entry became a central issue in 2000, and economic plans were tweaked to reach that target. Both IMF and World Bank granted loans to the country to support Lithuania's further economic reform programs.

#### **4.8.7. Russia**

It is the largest country in the ECE and accounts for some 40% of ECE population statistics. For over 70 years, Russia vigorously prosecuted the communist experiment, rigorously practicing state ownership and control of industrial enterprises. However, almost immediately after the fall of communism, Russia declared its intention to adopt a market economy and to undertake an extensive privatization program. Indeed, Russia has been undertaking a number of economic reforms since the mid-1980s (Edwards & Lawrence 2000). The economic reform package introduced by the government in 1992 signaled the rapid — and, in many respects, excessive — transformation of the Russian economy (Edwards & Lawrence 2000), but the change came too fast, and the local market and existing centralized system were homogenously incapable of handling the situation. The fallout of such revolutionary measures on Russian society and economy are complex, entailing many contradictions. Nepotism, gifts, bribes, and price fixing are accepted in traditional Russian business behavior; moreover, practices like the manipulation of data and non-adherence to (arguably senseless) laws and regulations are not considered strictly unethical (Puffer & McCarthy 1995; Johanson *et al.* 2000). Since 1990, Russia has experienced a substantial economic decline, as measured by a range of indicators. Output has plummeted across the traditional sectors of industry, agriculture, and construction; in 1998, these figures were only 46%, 58% and 31% of 1990 levels, respectively. There was also a sharp increase in official unemployment during the same period, exceeding 11% by 1997. Not surprisingly, real wages have declined on average (Wirtschaftslage und Reformprozesse in Mittel- und Osteuropa 1999; Edwards & Lawrence 2000).

August 17th, 1998, was a veritable economic meltdown in Russia: "The government defaulted on its debt, the banks became insolvent, and the stock market crashed" (Goldman 1999). While plenty of opportunities arise, some

investments are subject to high risk, especially in Russia. Many of these arise from unlikely sources, such as individualist attitudes retained from the earlier regime and confused structures of ownership and control (Estrin & Meyer 1998). Unfortunately, modern Russian firms lack knowledge regarding how business is properly conducted in a market economy (Salmi 1996).

#### **4.8.8. Yugoslavia**

The Yugoslav Federation, consisting of the republics of Serbia, Montenegro, Croatia, Slovenia and Bosnia-Herzegovina, existed until 1989, was well-known for its unique model of socialism. By a constitutional law of January 1953, state ownership of property was transferred to the population (Edwards & Lawrence 2000). Social ownership combined with decentralization of governmental functions established a system which differed substantially in many elements from the Soviet model, which emphasized state ownership and control (*ibid.*).

In the early 1990s, the Yugoslav Federation began to disintegrate, although this process was fiercely resisted by Serbia, the present Yugoslavia. Slovenia was the first of the Yugoslav republics to leave the Federation, declaring independence in 1991. Other republics — Croatia, Macedonia, and Bosnia-Herzegovina — subsequently declared their own independence. In the case of Croatia and Bosnia-Herzegovina, secession was followed by intense warfare between competing ethnic groups. These wars were devastating for the whole region, particularly for Yugoslavia (Serbia), due to 1999 NATO intervention. The economy was practically ruined, and the country experienced a long period of political instability until the government was ousted via election and resistance in late-2000. The sanctions against the country have since been waived, but a comfortable recovery will still take many years.

### **4.9. Summary**

The discussion of general environments within ECE has been concentrated on several vital issues: such as social and political situations, cultural issues, economic development, privatization, and foreign direct investment. It is observed that successful privatization and abilities to attract foreign capital have played major roles in the development and economic growth of countries there. Russia initiated privatization quite early, and on an impressively large scale, but its apparatus and socio-political structures were not sufficiently

sturdy to accommodate such changes. Based on political and economic stability and growth, inflows of foreign capital, adaptation to the market economy archetype, and privatization, a classification of ECE has been conducted.

The *fast adapters*, the most advanced group of countries, have largely succeeded in adopting market economies, and have attained positive economic growth. All of these countries are considered potential candidates for European Union membership. Countries in the second group, the *medium adapters*, have come some way in the development process, but are lagging in key respects. However, the tiny Baltic state of Estonia is doing exceptionally well, very closely following the fast adapters, and is determined to get into the EU as soon as possible. The least successful ECE countries are the *slow adapters*, which have had difficulty adjusting to their new situations and meeting the challenges posed by the market economy. None of these countries have demonstrated reliably positive signs of economic development, and have yet to regain the growth levels of the late-1980s. Also, foreign investment has been very low in these slow-adapting countries.

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## Chapter 5

# Theoretical Framework

The theoretical framework of the study includes three groups of variables (see Figure 1). The first group covers elements of the *general environment*. The second group, which constitutes the central part of the model, contains four variables, i.e. *motives*, *resources*, *learning* and *performance*. The final group includes the network and variables related to it. In analyzing joint ventures, Hennart (1988) finds that most of the related theories in the field are static, although the joint venture itself is inherently dynamic. The present framework therefore follows a dynamic approach in which variables influence and are influenced by each other, and the alliance itself has also been recognized as a process. General environment is, however, an exception since it influences the alliance but is rarely influenced from the other direction.

The variables of general environment and network have been adopted from the network approach. As the alliances in this study operate in an international milieu and the partners belong to different countries with differences in attitudes, values, and social and economical backgrounds, the impact of environment on such relationships will be important. A network is constituted by a set of two or more connected business relationships. An alliance may be a relationship already developed within the firm's network, a deepening of an exchange relationship within the existing network, or a collaboration between completely new partners from two different networks. The third of these (i.e. an alliance between new partners) will cause an extension of the partners' networks. In this context, an alliance is an exchange relationship which constitutes a part of the network. Networks can help firms expose themselves to new opportunities, obtain knowledge, learn from experiences, and benefit from the synergistic effect of pooled resources (Chetty & Blankenburg Holm 2000). However, it is important to note that all exchange relationships in the network are not alliances.

Resources constitute the central issue in the resource-based view and also play an important role in the network theory, and will be considered the focal

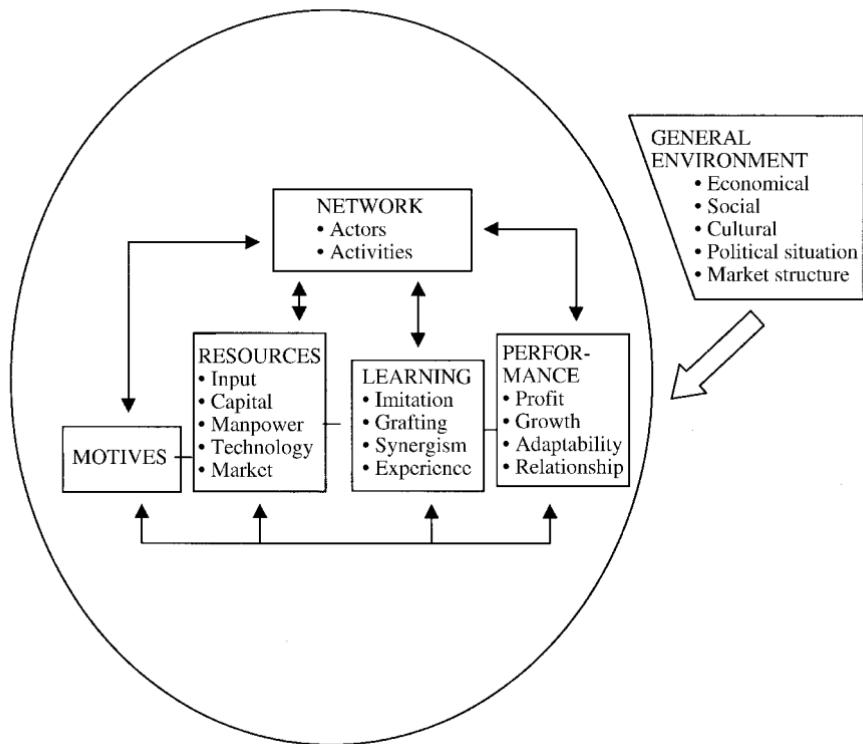


Figure 5.1: A theoretical framework for strategic alliances.

point in the present study. Here, a resource is not only considered in relation to other resources, but the impact of the environment on resource exchange will also be considered. Complementarity of resources has been emphasized as a major prerequisite for successful operation in alliance literature (see Varadarajan & Cunningham 1995; Tsang 1998). The motives of the partners explain why they enter into a strategic alliance, what benefit they derive from the alliance, and what interest they attach to the continuation of the relationship.

The performance, which in fact reflects the outcome of the alliance, is often decisive in explaining the partners' overall feelings for and interest in the strategic alliance. Good performance leads to better understanding and renders the partners further motivated to work for the alliance. Exchange and combination of appropriate resources has a major impact on the operation and

overall performance of the joint activity. Learning, also a component of the resource-based view, is another variable, which partners undergo during the process of strategic alliances. Learning is usually a consequence of performance which in turn markedly influences the motives and resources contributed by the partners. According to our framework, the alliance, which is a combination of motives, resources, learning and performance, operates within the network context of the greater general environment. The individual variables of the framework are presented in more detail below.

## **5.1. Motives**

To understand an alliance, it is necessary to investigate why it has been formed, or, in other words, why the partners have felt the need to establish it (see Hyder 1999). As this study is conducted from the Western firm's perspective, it is mainly the motives of these firms that will be dealt with. Two types of motives can be distinguished: the first relating to alliances in general, and the second relating to alliances operating in Eastern and Central Europe. From a general standpoint, a collaboration may provide an opportunity for one partner to internalize the skills (i.e. learning) of the other, and thus improve its position both within and outside the alliance (Hamel 1991). Hennart (1988) argues that one of the main objectives for establishing joint venture is to pool complementary bits of knowledge. Osland & Yaprak (1994) argue that in developing new technologies and transferring sensitive technologies, joint ventures constitute the most desirable structural form of alliance. Varadarajan & Cunningham (1995), who offer a conceptual synthesis of strategic alliances, argue that pooling of specific resources and pooling of skills by the cooperating organizations are the main motives for alliance formation in order to achieve common, as well as individual partners' goals. Motives for developing new relationships can also include the desire to enter attractive markets, acquire critical and scarce resources, and learn new marketing procedures, production techniques, etc.

Culpan & Kumar (1994) discuss three general motives of Western firms, i.e. minimizing transaction costs, acquiring needed resources, and gaining competitive advantage in alliances. Transaction costs refer to expenses incurred for writing and enforcing contracts. The simple argument for this is that if transaction costs in the market are high, firms will enter into collaborations to reduce the cost of each transaction. Resources, such as skilled and semi-skilled manpower, local contacts, local market know-how, partner locations and factories, etc., can be attractive motives to foreign firms. In ECE, competitive

advantage and legitimacy can be gained by engaging in an alliance with a local partner. Culpan and Kumar find motivations of Western firms to be linked to the criteria of partner selection. For instance, choosing a partner on the basis of its market position or local connections reflects competitive advantage and transaction cost perspectives, respectively.

Fahy *et al.* (1998) have examined the motives and experiences of British firms with international venture partners in Hungary. Their findings identify two major motives for forming these collaborative ventures: market-seeking motives and resource-seeking motives. In the latter, access to skilled, and low-cost labor and government incentives are considered important by foreign partners. Overall, establishing cooperative linkages is considered the strategic response of Western firms to Eastern European market opportunities. (Culpan & Kumar 1994). Table 5.1 summarizes general as well as ECE-specific motives for forming strategic alliances.

## 5.2. Resources

In a resource-based view, a firm's strategy is developed by focusing on its resources instead of the external environment. Barney (1991), one of the most prominent researchers in the field, asserts that resources can be classified into three categories: physical resources, human capital resources, and organizational capital resources. The first of these, *physical resources*, includes physical technology, a firm's plant and equipment, and its access to raw material. *Human capital resources* concern the human element in the organization. The final category, *organizational capital resources*, includes a firm's formal reporting structure, planning, controlling, etc. This classification is elaborate but does not consider the marketing effort and marketing ability of the partners as important aspects in establishing alliances.

In describing exchange of resources in joint venture, Hyder & Ghauri (2000) have applied five resource categories, i.e. *input*, *capital*, *manpower*, *technology* and *market*. As this classification also largely covers the resource categories of Barney (1991), we find it relevant for our present theoretical framework.

### 5.2.1. Input

Ahn (1980) has described *input material* as one of the factors that motivates foreign firms to enter joint ventures in developing countries. The current

Table 5.1: Western firms' motives for entering alliances – General and ECE-specific.

Types	Motivating factors	Comments
I. General alliances	1. Reducing transaction costs 2. Gaining competitive advantage 3. Learning from other partners 4. Obtaining complementary resources 5. Entering attractive markets	Motives 1 & 2 often used as theoretical explanations. Motives 3 & 4 received both theoretical and empirical attention. Motive 5 discussed in connection with developing countries.
II. ECE-specific	6. Market opportunities 7. Local identity and legitimacy 8. Local assets and resources	Motive 6 seen as an immediate advantage after the fall of communism. Motives 7 & 8 related mainly to privatization.

situation in the ECE is in many ways comparable to a number of developing countries. Russia, for example, is known for its abundant natural resources such as petroleum and forest products. Input can be procured through market mechanisms or through establishing long-term contracts with suppliers (Hyder 1988). In an alliance, if the applied technology is completely new to the local associate, the foreign partner's support may be necessary. A foreign partner can either have his own source of supply or negotiate with other suppliers on behalf of the alliance. The latter situation generally arises when a foreign firm does not manufacture the products itself (*ibid.*).

### ***5.2.2. Capital***

All alliances do not require direct financial involvement. For example, if a collaboration aims only to develop a certain product, it may be enough to combine technical resources and support from the partners. The necessary costs can be taken care of individually by the participating firms. For practical reasons, however, some financial involvement is essential in most alliances, as well as for ensuring the partners' commitment to the joint effort. In a joint venture, partners share the ownership and take financial risks jointly. Investing capital to acquire equity ownership is not always necessary; partners can very well invest in kind. The partners' vital resources, such as, plants, machinery, technology, good-will, etc., can be appraised and included in the ownership. In general, the ECE runs short in capital and prospects for finding private owners capable of making financial investments in joint ventures. However, it is possible that local parties have other assets which are valuable in the formation of joint ventures. Historically, a joint venture type of alliance has been more acceptable in the ECE, as it offers local technicians and managers an opportunity to work and learn in close collaboration with the Western managers.

Even major parts of a foreign firm's equity ownership are normally constituted by kinds of resources other than those of a purely financial nature. In the form of foreign direct investment, the foreign firm brings with it not only capital — but also a package of resources, including technology, management skills and the hope that it will transfer cultural values of entrepreneurship, risk-taking and a work ethic (Buckley & Ghauri, 1994). In the beginning, parties may agree with relative ease on their level of equity ownership because they usually know what they expect from the venture. But in the long-run, the issue of capital can become more complicated due to performance outcomes and changing attitudes of the partners.

### 5.2.3. *Manpower*

Every organization needs manpower to carry out the operational activities according to the programs agreed upon. This can be divided into *skilled*, *semi-skilled* and *unskilled* manpower. Skilled manpower signifies that the individual has specialized knowledge and sufficient expertise to initiate and terminate a job in the field (Hyder 1988). In ECE alliances, expatriates who usually come from the foreign partner, are likely to play a vital role in transferring technology to the local technicians. The supply of manpower for a firm is determined by:

- (1) the availability of manpower in the neighborhood of the local firm. This ‘neighborhood’ may cover a particular region or a country;
- (2) the availability of manpower in the international market; and
- (3) the ability of the local firm to locate, contact, screen, negotiate and recruit manpower from the regional, national, or international market (Sharma 1983).

One of the main reasons why foreign firms enter into alliances in the ECE is to gain access to qualified local manpower at relatively low costs compared to Western standards. The opening of Central Europe made millions of skilled, low-cost workers available to Western companies seeking new bases of operation and new markets (*BusinessWeek* 1999).

### 5.2.4. *Technology*

Technology is the package of product designs, production- and process techniques, and managerial systems used to manufacture particular products or to offer services. Tsang (1998) describes technology as a body of technical know-how consisting of two types of knowledge, namely, explicit and tacit. The former, explicit knowledge, is embodied in designs, blueprints, drawings and specifications, while the latter, tacit knowledge, is housed in the brains of humans. Tacit knowledge requires firms to collaborate in order for technological transfer to take place. In the ECE, governments and local private firms have a vested interest in coming into contact with foreign technology to develop their technical competence and competitiveness. Discussion and agreement on how technology is to be obtained is often crucial to planning, negotiating and forming an alliance, particularly alliances that will be engaged in manufacturing.

### **5.2.5. Market**

An alliance can either cater to the local market, to the export market, or a combination of the two. Market is often one of the main reasons why foreign firms become interested in entering a new country. This is particularly true in the ECE, as most researchers have recognized market opportunity as one of the main motivations for foreign firms' investment in the region (see Tietz 1994; Jain & Tucker 1994; Estrin & Meyer 1998; Fahy *et al.* 1998). However, as products were distributed — not sold, and collected by the customers, marketing is a totally new concept for ECE countries. Earlier, it was a seller's market and whatever was produced was consumed. The situation is now changing and market forces are now in effect in many Eastern countries. Market access is therefore a resource that can provide a competitive advantage that is more enduring than most technological resources, especially in the light of rapid technological change.

## **5.3. Learning**

Firms can learn through at least four processes: *experience, imitation, grafting* and *synergism* (Osland & Yaprak 1994). Experience is defined as the learning that takes place through experiment and trial and error. Several aspects of learning from experience are important in joint ventures:

- (1) the relatedness of the joint venture's mission to the parent firms' goals;
- (2) the number of past joint ventures in which the parent firm has been involved;
- (3) the experience of the individual managers as it relates to past joint ventures (Lyles 1994).

Experience gained from previous collaborations is closely linked to partners' motivations and therefore positive experience may be a decisive factor when entering into new relationships.

Imitation is an attempt to learn about the strategies, technologies and functional activities of other firms, and to internalize this second-hand experience (Osland & Yaprak 1994). In the literature of the resource-based view, the ability to successfully imitate others' resources has been described as an important source of competitive advantage, and a resource can only be imitated through close cooperation between partners. However, there are two types of imitation, namely, open and secret, that take place in a strategic alliance (Tsang 1998). Licensing is an example of open imitation, where the

licenser agrees to let the licensee learn about and use the technology under specified conditions. In secret imitation, the owner of the resource has no intention of letting the partner imitate it. However, there is also another type of learning — joint learning — which can benefit both the partners simultaneously, and which takes place through combining the partners' complementary resources. The purpose of this learning is to acquire joint competitive advantage over others by introducing new products/services, creating new applications for existing products/services, or opening new fields of business.

According to Huber (1991), grafting is a way of acquiring knowledge through the formal acquisition of another firm or through establishing an alliance with another firm. Here, the transfer of knowledge takes place in a more formal setup than in the case of learning based on mere understanding. Synergism occurs when firms collaborate to produce new knowledge. The conclusion drawn is that all the four processes, in varying degrees of occurrence and importance, are relevant for learning in strategic alliances.

The learning that takes place between the partners is usually asymmetrical because all partners do not have the same ability and competence to learn (see Hamel 1991). As a partner may be eager to learn faster than its counterpart, one can expect competitive learning in the alliance. A partner who is capable of learning from another partner strengthens his bargaining position in the relationship, while the second partner will experience a decline in strength. Due to differences in the organizational learning capacity of the partners, benefits are appropriated asymmetrically (Pucik 1988). Asymmetric strategic alliances are most when cooperating firms are different from each other (Barney 1996).

## 5.4. Network

The idea of network has become important because no firm is self-sufficient. A firm must therefore engage in continuous exchange with its environment for survival. Network is concerned with exchange relationships among firms operating in the market and with other organizations and individuals who have an interest or can play some role in the development of the business. Cook & Emersson (1974) and Granovetter (1982) talk about *social networks*, which are built on social relationships. Social exchanges can develop into social bonds and these bonds can facilitate and promote various types of business exchanges. Industrial marketing researchers have advanced the concept of *industrial networks*, which are viewed as sets of connected exchange relationships among actors who control industrial resources and activities (Johanson & Mattsson 1988; Håkansson 1989; Håkansson & Snehota 1990).

The industrial network refers to the exchange of various resources and the activities performed in the exchange process, whereas the social network refers to actors and their social relationships (Abraha & Hyder 1997). Both social- and industrial networks are important and complementary in developing long-term business relationships.

Network theory (Johanson & Mattsson 1988) is based on three major factors:

- (1) *actors*;
- (2) *activities*; and
- (3) *resources*.

Actors can be individuals or firms who get involved in a network relationship. The exchanges and transactions that take place between actors are the activities. All actors are not equally active and all activities are not equally important in the network. However, the network approach considers relationships among different actors to have a long-term and relatively stable character (Abraha 1994). Actors engage in relationships to acquire resources. Different actors take part in activities within a network to exchange information and resources in order to strengthen their position (Ghauri & Holstius 1996; Abraha & Hyder 2000). The more critical these resources are, the more intensive the activities will be. Because the main reason for partners entering into alliances is to complement each other's requirements, resources are considered to be the core variable in both the network theory and the current study. Due to this central position, resources have not been considered as a part of a variable, i.e. network, but rather are viewed in the study as a separate variable.

Due to the establishment of strategic alliances, partners come across, and many times gain entrance to, each other's network. Network development, i.e. coming into contact with new actors, has been described by network theorists, such as Johanson & Mattsson (1988) and Håkansson (1989), as a useful asset that can be created by the exchange relationship between the main actors. The concept of network has two dimensions in this study. One of these dimensions is purely in line with the overall aim of the strategic alliance. Here, both partners provide more active support and get involved in each other's network primarily to increase the competitive strength of the alliance or to enter into a new field of business together. As partners combine their networks, more learning and adaptation take place, which has a synergetic effect on the overall relationship. A new network may be formed around the alliance to increase the partners' competence in seeking, acquiring and using their resources and skills to support the alliance.

The second dimension primarily concerns the fulfillment of individual goals through coming in contact with each other. A strategic alliance functions here as a legal platform, which partners employ to get to know and make use of each other's contacts as a way of strengthening their individual position. Here, the partners seek to develop their existing networks by including new contacts and relationships significant for raising their individual competence and entering new markets. This type of network formation does not always confer direct benefit to the alliance but may be helpful in creating reliance and confidence in the relationship between the partners. How firms develop and utilize networks is especially important in the ECE because networks are to a large extent expected to dictate the capacity of the strategic alliance and the partners to mobilize external resources.

## 5.5. Performance

Measurement of performance is important because partners have certain expectations, and because the outcome of an operation may require a capable partner exercising more control, raising more funding or extending further cooperation by the partners. Performance may be measured in relation to the *partners' interests* or according to common criteria for *organizational effectiveness*. Partners' interest refers to the degree of interest partners have attached and continue to attach to the strategic alliance. The other measure of performance, i.e. organizational effectiveness, is an external measure of performance regarding how well an enterprise is able to manage its relation with the parties concerned (Pfeffer & Salancik 1978). In the literature, five criteria, i.e. profit, growth, adaptability, joint participation in the activities and survival, are often used to measure alliance performance (Hyder 1988; Boersma & Ghauri 1997).

*Profit* refers to the revenue from sales that remains after all costs and obligations have been met. *Growth* is represented by an increase in variables such as total manpower, plant capacity, sales, profits, market shares and number of innovations. Growth implies a comparison of a firm's present to its past state. Profit and growth are two frequently used criteria in the measurement context. *Adaptation* refers to the ability of a firm to change its standard operating procedure in response to environmental changes. The need for adaptation is great in alliances as they involve parties with different cultures, backgrounds and objectives. Adaptation is an important aspect in the theory of network. *Joint participation* means that each partner has to perform some organizational function in the alliance. Neither partner may be passive and each must

contribute (Harrigan 1986). Participation by the partners need not be in the same area or of equal importance. It is essential that both partners feel the need to do something for the alliance, otherwise the collaboration will be futile. *Survival* is the ability of a firm to exist without any basic change in structure or goals as set from the beginning. We argue that joint participation and survival of an alliance are closely related aspects and that, together, the two lead to a strengthening of the relationship between the partners. Survival of an alliance may be less of a concern if the partners succeed in developing a strong association, which lies behind many productive alliances and success stories. We therefore combine these two sub-variables under the name of *relationship*.

## **5.6. General Environment**

The general environment in which a strategic alliance is to operate is crucial because it offers both opportunities and limitations for the relationship, yet is not in control of the collaborating firms. In the international environment in particular, the situation is more complicated, since the social, cultural and political backgrounds of partners are different. To understand such an environment, it is therefore important to consider both micro and macro forces. This environment consists of a number of elements, including economic forces, legal constraints, socio-cultural forces, technological development, etc. (Bradley 1999). As Håkansson (1982) argues, an interaction cannot be analyzed in isolation but must be considered in a wider context. There are several aspects to this wider context, i.e.:

- (a) market structure;
- (b) dynamism;
- (c) internationalization;
- (d) position in the manufacturing channel; and
- (e) the social system.

A successful analysis of an alliance in the ECE will largely depend on the researcher's ability to understand the mechanism of local environmental and its impact on the relationships.

In this study, general environment is comprised of five sub-variables:

- Economic conditions;
- Political situation and government regulations;
- Social system;
- Cultural factors;
- Market structure.

### ***5.6.1. Economic Conditions***

By economic conditions, we mean all economic activities that affect a country's past and present economic situations and future economic developments. Economic conditions include, for example, economic growth, living standards, export, import, balance of trade, foreign currency reserve, foreign direct investment and industrial resources. Although this sub-variable looks at things at the macro level, individual businessmen capable of investing are also particularly important in an ECE country. With alliances operating in the ECE, it is crucial for foreign investors to know the economic state of affairs in a country and what support they can expect from the local sources. This support need not be of an exclusively economical character, but the economic conditions of prospective local associates, on the other hand, cannot be underestimated. If the potential local partners are not financially solvent, they will usually seek short-term benefits and also find making further investment difficult.

### ***5.6.2. Political Situation***

The role of government is crucial in creating a good business climate through the formulation and practice of appropriate business policies. There is evidence that, in developing — as well as ECE countries — governments take an active part, either as partners or as observers, in dealing with foreign investors (see, e.g. Abraha & Hyder 1997; Buckley & Ghauri 1994). The Kenyan government plays a prominent role in the economy, through adoption and implementation of development plans, economic policies and regulations, fiscal policies, trade policies, etc. (Kaplinsky 1978). In general, foreign investors do not like local governments as partners. Privatization in the ECE has therefore had a very positive impact on foreign investment and on involvement in alliance-type business collaborations.

### ***5.6.3. Social System***

The social system largely dictates which businesses are socially acceptable in a country, how they are organized, operated and evaluated, and what roles managers and employees are supposed to play. The attitude toward foreign investment is especially significant in the ECE due to the many years' of suspicion toward Westerners and the ongoing transition from centrally planned

economies to market economies. The social system is particularly relevant in the international context where attitudes and perceptions can, on a generalized level, constitute *major* obstacles when trying to establish an exchange process with a certain counterpart (Håkansson 1982).

#### **5.6.4. Cultural Factors**

Hofstede (1991) has described culture as the ‘software of mind’ which makes one group of people think differently than another. Although the role of culture in international business has been identified for quite some time, the understanding of its real importance is a rather recent discovery (see Harris 1998; Harris & Gahuri 2000). Two types of culture are of importance: *national culture* and *organizational culture*. National culture is a culture based on values and is mainly learned in one’s early years. Steenkamp (2001) has investigated the role of national culture in international marketing research and argues that it must be considered in doing business with foreigners. This is particularly true when ECE countries with varied cultures collaborate with Western firms. When firms diversify beyond their national borders, they must adjust to the foreign national culture (Barkema *et al.* 1996). The latter type of culture, organizational culture, is made up of a firm’s procedures and practices, which employees act upon and which guide them in carrying out organizational functions.

#### **5.6.5. Market Structure**

In the interaction approach, Håkansson (1982) has used structure of market to observe the concentration of buyers and sellers and the stability or rate of change of the market and its constituent members. The interaction approach also considers the extent to which the market can be viewed as strictly national or international. In this study, we see market structure from a wider perspective, and it does not necessarily involve only buyers and sellers, but can very well encompass competitors, competitors’ competitors, buyers’ buyers, etc. Furthermore, market structure is viewed only in an international context, and here restricted to ECE. Not long ago, ECE countries maintained planned economies, where the concept of marketing was totally unknown. At that time, they had no market orientation and simply concentrated on production and supply. While the Western firms studied practice market economy, the host ECE countries are passing through a transition period. Market structure is therefore interesting for

this study and requires special treatment in order to observe its impact on the alliances.

This section has discussed general characteristics of the environment in which firms must operate. The classification of ECE presented in Chapter 4 therefore has a natural link with environment as all of the alliances studied belong to this region. The impact and significance of the five general environment sub-variables will be different for individual ECE countries due to factors such as economic development, direct investment, level of privatization, etc. Therefore the classification of ECE does not compete with the discussion on general environment but can be seen as a necessary tool for understanding why certain countries are more attractive for alliance formation and operation while others are falling behind in the pursuit of modernization and adaptation objectives. We see the classification of ECE and the variable of general environment as two separate but complementary issues.

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# **Part 2**

## **Case Presentation**

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## Chapter 6

# Alliances in Fast-Adapting Countries

### **6.1. Paroc Rockwool in Poland**

Paroc is one of the leading mineral wool insulation manufacturers in Europe and has its head office in Finland. It has almost 50 years' experience of developing, manufacturing and distributing stone wool products for use by the building industry and other industrial applications. Paroc is currently the leading stone wool manufacturer in the Baltic region, with Sweden and Finland as its main markets. Annual turnover for 2001 was more than 2.2 billion Swedish Crowns. Paroc also has plants in Finland, Sweden, Poland and the United Kingdom, plus sales companies in 14 European countries. It employs approximately 1,800 people.

#### ***6.1.1. Motives***

The purpose of forming the alliance was Paroc's need of risk financing. For this reason financial institutions had been selected as local partners. Paroc did not want to invest all the funds necessary for the operation. It had a policy to search and secure project financing in these new economies — the former Socialist bloc. Risk financing means there are no guarantees from the parent company. The lenders were ready to finance this project because in principle they were familiar with this concept of risk financing. However, even though the financial institutions were practicing the concept of project financing, a proper form of asset security was needed for each project. A specific legal design suitable in Polish circumstances had to be developed and applied: this consumed a great deal of time.

#### ***6.1.2. Establishment of the Alliance***

Paroc considered Poland as an attractive market for expansion of its international activity. The company believed it would be a market with strong

growth of production materials in general and insulation materials in particular, specifically during the coming fifteen to twenty years (i.e. up until the year 2015 to 2020). Paroc was aware that it was a late starter in Poland as its competitors were already established in the market. It was necessary for Paroc to establish itself quickly. A green-field investment was totally out of the question. It therefore decided to acquire a local company, which was already operating in Poland and producing rock wool products. It gradually found a state-owned company that was interested in selling shares as part and parcel of the governments' privatization program.

In March 1998, Paroc took over the Polish company that had been dealing in the same business area. But to avoid taking the full risk, it built a joint venture with three financial institutions as local partners. Paroc took the initiative of building the JV. The negotiation with the financial institutions was a time consuming process. The three financial institutions jointly hold 52% of the shares, with Paroc holding 48%. This was the same design Paroc initially had when entering the Lithuanian market. It suggested that the financial institutions have the majority of the shares, and this was accepted. Paroc wanted the shareholders to become engaged as both shareholders and lenders. Moreover, Paroc believed it to be advantageous in the initial stage not to consolidate the business into its own accounts.

The process of acquiring the assets from the already existing company was very complicated. The contracts for forming the alliance were signed in late 1996 and then it took a year and a half to complete the asset transfer. The company had a pair of production lines with a good infrastructure and good location and employed about 200 employees. Paroc started by re-building the production lines and invested a great deal, not only in manufacturing but also in training, especially in the areas of sales and marketing. Production started by the end of April 1998. When the alliance started its operations, many employees had no professional experience. During the first two years (1998–2000), Paroc had built up human resources of competent sales and marketing people, which made the alliance very efficient in its sales and promotion activities.

### ***6.1.3. Resources***

Paroc's major contribution in the JV was its expertise in insulation technology. Financial Partners are experts in risk financing, in which this alliance has also been involved. Due to its technological competence, Paroc has been in charge of seeing that everything is in order. From an operational point of view, it is

Parocs' responsibility totally to perform the proper management and follow-up of the operations of the JV. Specifically, Paroc is responsible for technology, marketing, product development, production, market development, training and recruitment of manpower, procurement of raw materials, and in fact all operational activities. If there is a need for additional financing it is also Paroc who takes up the matter for discussion, primarily with the financial partners and eventually with other financial institutions for additional funding.

Paroc built up its own sales organization by employing local people. It promptly developed the operations of the JV and upgraded the old plants and production lines technically. This enabled the JV to produce substantially improved quality products at lower cost. After about a year, Paroc started to transfer the modern technology, which was being used in Finland, Sweden and Lithuania. Such a transfer required an investment of about 200 million Swedish Crowns in a new, large and modern production line. In the rock wool business, technology is a key factor in gaining a competitive edge. There are no production lines to buy in the open market, therefore a company possessing such a production and technological know-how becomes a strong player in the market. This competence is one of the strengths of Paroc Rock Wool.

The upgrading of old production lines as well as transfer of the modern technology and investments in the modern and new production plants were financed by the financial institutions which were major shareholders of the alliance. In the project financing, a fourth financier, International Financing Corporation (IFC), was also involved. An initial agreement was reached with the financiers that they would inject fresh money in the development of the factory. Paroc was in favor of such a solution as it would need less of its own capital and would thereby reduce risk. It thus has a policy of utilizing its opportunities and minimizing its risks. According to the contract, Paroc, however, has the right to buy further shares from its partners, the financial institutions.

#### ***6.1.4. Learning***

What Paroc has learned was mainly derived from its own employees and the contacts it had with the other parties operating in Poland. It has learned about the bureaucratic set-up and the need to live with the local bureaucracy. The bureaucratic pressure can be reduced to some extent, but largely has to be dealt with by the help of local experts. Paroc recruited about 200 employees, and almost all of them were the former employees of Izopol SA, the company from which it acquired the assets in the early stage. Paroc understood very well that

the Western way of doing business would not function for local sales and therefore found the role of the local employees crucial in dealing with the 8,000 local customers. Even the distribution system was different in Poland compared to the West. Things were changing, but it would take some time to establish a well functioning distribution system. There was no dealer chain for ultimately distributing the products to customers. This structure has made Paroc's operations both difficult and easy. One has to deal with one decision maker, the centralized decision-making process makes one's operations easier. There is also difficulty because with only one decision maker, there are equal chances of gaining or losing. However, if there are several decision makers in independent companies, the chances of getting the total business are fewer, but the chances of gaining positive outcomes are greater. From a financial point of view, dealing with smaller independent companies is more risky. This implies a need to have strict control over the customer credit system. Paroc learned to design a tight control credit system, and it functioned well.

### ***6.1.5. Network***

When Paroc negotiated with Izopol SA about the acquisition of assets, they had a common interest in obtaining the necessary approvals from the authorities. Both parties worked together in establishing contacts with the relevant government bodies. The main authorities, which both the parties dealt with, were the Regional Environmental Authorities, and the Local Municipality about the building permits. Paroc's contacts with the dealers had to function well as they had to represent Paroc in the market. The role of the dealers was twofold:

- (1) making the products available through their outlets so that customers could go there and obtain an insulation package; and
- (2) acquiring market knowledge and making sure that the products were used at the building site and that the necessary feedback was sent to Paroc on how the products were functioning.

### ***6.1.6. Performance***

The cooperation with the financial institutions fulfilled the expectations of Paroc. The financial institutions supplied money to the alliance both as lenders and shareholders according to the terms and conditions of the agreement. As to

production and marketing, Paroc was fairly content about the situation in Poland. Many things could still be improved, but the way Paroc's manufacturing operations developed had been a successful part of its overall activities. Paroc was still a newcomer in the market and wanted to acquire a thorough grip on the Polish market. However, its plans for establishment in Poland were largely realized.

Paroc wanted to continue the cooperation arrangements with its partners in the Polish market. The reasons why Paroc established its joint venture were still valid. Paroc's partners are also satisfied with the performance of the JV. Paroc could deliver its partners what it promised. The partners had experience of working with Paroc in other projects: For example, they carried out a joint project in Lithuania that continued for six years. Paroc regularly allowed the partners, which were in fact financial institutions, to go through the financial position of the joint company. The partners found Paroc very competent at profitably running the business.

### ***6.1.7. General Environment***

The Polish culture is in a kind of transitional stage of development towards an advanced market economy; however there are many strong remnants from the old socialist bureaucracy era. The level of bureaucracy in Poland is far greater, and has slowed down the operations of the JV in many respects. Paroc's managers have to deal with bureaucracy both in the company and in its relations to the authorities. This problem is common to all actors operating in the Polish market. A great deal of time has to be devoted just to fulfilling the demands of the bureaucracy, i.e. reporting in a special way. These types of dealings with the authorities are not common in the West.

Paroc Rock Wool is doing well but the situation often becomes complicated, as doing business is different from that in the West. The actual consequence is mainly the waste of resources. To a certain extent various working processes and decisions are also delayed. Mainly, complications are created in doing business and such complication takes away resources from more useful activities.

The employees were used to an authoritarian style of management during the socialist era: the boss was really a boss. This is changing with the transition to the market economy. As a part of this process, the employees are willing to take more responsibility for their areas of operations. Paroc wants them to take a high degree of responsibility, but things are developing gradually. A great deal of training is required and Paroc is providing this. This makes the company's

operations slow and expensive, however, due to its huge investment in competence development.

There are no local sources of long-term financing and this is the main problem of all business entities operating in Poland. This is dealt with by developing well functioning relationships with international financial institutions as discussed in the purpose of forming the JV as well as the resources contributions section.

Rules and regulations — the rules in general and the taxation laws in particular — can and do change in an unpredictable manner. Whether Paroc would establish a new JV with its current partners or not depends on the situation. It is difficult to generalize that collaboration is always the best solution. To set-up a JV based on project financing but not on guarantees from a parent company is a very elaborate process. It is time-consuming, requires a great deal of effort and is costly getting everything in place. It is appropriate if a financially substantial investment is involved, but too much work if it concerns only a small project. The project in Poland, however, is a large project so what Paroc did was a good solution. It is thus worthwhile considering the risk and the size of the project.

There were two major risks in Poland. First, when Paroc started doing business as an outsider it was a totally unknown territory. Going to an unknown territory with this special background of being a former state economy is always in itself a risk. Second, there is risk of a more commercial nature. It is known that Poland is a very promising market and many firms want to conduct business there. Therefore, the proper form of entering the market has to be carefully designed if the commercial and environmental risks are to be correctly handled. If the project is large and the situation is risky, such cooperation is useful, on the other hand if the project is small and the situation is not risky there is no reason to get involved in such types of cooperation or strategic alliance. JV decisions are a balancing act. The financial institutions are prepared to take some risks, not all types of risks. If the risk falls within the sphere of interest of the financiers and the project becomes important, they are willing to make an investment. If the financial institutions are familiar with the local environment from earlier experience, they will be inclined to finance a project.

## **6.2. PLM in Poland**

PLM is the beverage packaging section of Rexam, which is one of the world's ten largest consumer-packaging companies. In the beginning of 1999, PLM

was bought by a U.K. company, Rexam, to whom it still belongs. It has a top-3 position in its core markets. PLM's main products are cans, glass bottles, and different types of plastic bottles. Its main and large customers are the breweries, wine and liquor companies, water filling companies, food processing companies and pharmaceutical companies. It has can industries in France, Germany, Austria, Sweden and Russia; a glass division in Sweden, Germany, Holland, U.K., Denmark and Poland; and a plastics division in Sweden and the Czech Republic. Its factories are fully owned by PLM, with the exception of the Joint Ventures in Russia and Poland. PLM's sales in 1998 were 8.5 billion SEK, 9 billion SEK in 1999 and were forecast to be the same in 2000 as in 1999. The number of employees is 5,400.

### ***6.2.1. The Initiation and Formation of the Joint Venture***

In Poland, privatization started at two levels: the national government level and the Voivoda — local government level. Voivoda owned a factory by the name of Gostym. The government announced its privatization program and instructed Voivoda to invite different bidders for the sale of Gostym. Two items were critical in the bid: technical know-how and personnel. Bidders had to present a plan and the best planner would win the bid. Being state-owned, Gostym's market value was unknown. An independent adviser was appointed by the parties concerned to determine the value of Gostym, its agreed upon value. Negotiation was carried out between Voivoda and PLM for a year to form a joint venture. Finally, agreement was reached and Voivoda accordingly had to own 49% and PLM 51% of Gostym. It was PLM in 1995 that took the initiative to form the joint venture as it had the aim of operating in Eastern Europe. The joint venture was established in 1996 and started to operate the same year.

### ***6.2.2. Negotiations***

Voivoda was very demanding in the negotiation and had limited knowledge and experience of the negotiation procedures. The main problems in the negotiation centered on agreeing on three main issues:

- (1) cash injection;
- (2) the investment plan; and
- (3) the personnel plan.

The investment plan's minimum level was determined within a defined time frame of five years. One important component of the personnel plan was the

social package, i.e. its personnel benefits. It was an essential issue and was mainly composed of three things:

- (1) the wage level;
- (2) employment guarantees; and
- (3) participation in the company.

The state did not make any significant contribution to the joint venture formation process. In the negotiation and the signing of the contract, PLM had an option to take over the shares of the Polish Government (Voivoda). Voivoda was ready to give its shares to PLM after a certain period. It was a stepwise change to full PLM ownership of the joint venture from their side. The Polish Government believed it could obtain more for its shares if the change took a long time. According to Polish regulations, the 49% of the shares owned by Voivoda would be transferred to the employees. But in the long run, PLM is expected to take over the whole company.

### ***6.2.3. Motives***

The main reasons for PLM to build joint ventures are finding a partner with special competence which PLM lacks, decreasing risk of operating in a certain market, and being forced to do so because of government regulations. On the other hand, in implementing its privatization program, Poland was getting involved as a part owner in the new joint ventures. Two main reasons for PLM getting established in Poland were the size and development of the market. Moreover, it also wanted to follow its customers who were entering the Polish market. Poland, the Czech Republic and Hungary are the Visigrate countries — they don't belong to the East, but they were confiscated by Russia. The same is also true of the Baltic states: originally they didn't belong to the communist bloc or Russia. Traditionally, Poland, the Czech Republic, and Hungary belonged to Central Europe and the Baltic states to the Nordic countries. They are more similar to the West and if a foreign firm wants to enter Eastern Europe, it chooses one of these three countries. They are the most penetrable and convenient markets in the Eastern bloc for foreign firms as traditionally they have good contacts with the West.

### ***6.2.4. Resources***

PLM is the main active partner in the joint venture while Voivoda and the personnel has more or less a passive role. Voivoda is gradually transferring its

shares to its personnel. Both Voivoda and PLM are represented on the supervisory board. PLM's contribution includes management, technical know-how, marketing, R&D, financing, production technology and some personnel. It also offers training to the JV personnel on the spot. The personnel have already acquired 15% of Voivoda shares. However, PLM never expected any active contribution from the partners other than getting authority to operate the local company and have access to the market. PLM has visited other glassworks companies in Poland, and found that the joint venture personnel has a higher standard in terms of technology, market coverage, experience, and purchasing. This can be a positive factor in the collaboration.

### ***6.2.5. Learning***

PLM has learned from the JV on how to deal with bureaucracy. Moreover, it has also learned somewhat on how to change its employees' process of thinking from a planned to a market economy. The local partner is in the process of learning how PLM thinks and operates as well as how a market economy functions.

### ***6.2.6. Performance***

PLM has not achieved its objectives so far as the market has not developed as anticipated. The Russian crisis in the late 1990s affected the joint venture sharply as it had been a major market for its products. Poland had a large food and beverages market in Russia. With the overall decline of Polish exports to Russia, the joint venture's profit has been minimal. However, PLM has managed to maintain the customers that it followed to Poland and in that sense it has been successful, though the market has substantially weakened. However, as the JV has not been in operation for long, it is impossible to make a sound judgment of the JV's performance. However, the Polish partners can be said to have achieved their aim because a foreign firm took responsibility for the development and modernization of local enterprise. Moreover, the local employees have become more confident in their work after being trained by the foreign personnel.

PLM wants to continue collaborating as Poland is an integral part of Central Europe. The most positive aspect of the JV for PLM is the experience that it has gained and learned from operating in the Polish market. The negative aspect is the limited current market of the products. PLM is not considering entering

further privatization processes. Rather, it prefers negotiation with a private partner should it want to penetrate further into the Polish market.

### ***6.2.7. General Environment***

The business tradition in Poland is different from the West as there was no market economy in the country for many decades. A socialist environment prevailed in the region where there was a planned economy characterized by high inflation. Normally in the ECE, all prices were regulated depending on the inflation rate. Prices of goods and services were not at all negotiated, as there was a central organ that decided all prices. In Poland, companies had no marketing functions and no real purchasing departments. There was no need for those functions as they were centrally regulated. The business organizations produced whatever the state determined and customers had no alternative than to buy what was available in the market. In the planned economy, the state determined what should be produced, at what price to sell as well as the form and function of buyer-seller relationships. This business tradition determined consumer behavior in contrast to how it functions in the West. Customers had to wait long periods and the state determined for them what was to be available and at what price. In the West it is consumer demand that governs what to produce and the inflation level; prices are determined through negotiation in the market. Companies in the West make more aggressive advertisements. More consumer information and competition have more influence on customer behavior, which is in complete contrast to the ECE countries. However, market structures and the way the market functions are now changing in Poland due to investment from the West and a willingness to change to adopt the mechanism of the market economy.

In contrast to the West, the practice of shouldering of responsibility and working independently does not exist in countries like Poland. Organizational structures are centralized and hierarchical and people always depend on the higher level for decisions and clear instructions. It is really difficult to delegate responsibility to the lower level. PLM has attempted to handle this organizational problem through both short and long-term measures. In the short term, it has worked in a centralized and hierarchical structure, whereas as a long-term measure it has trained its local employees to take responsibility and work independently so as to develop a decentralized organizational structure. Managers have already noticed that it is a costly and time-consuming process to change the mentality and culture of people. Another cultural barrier is language. To handle this problem, PLM offers continuous language training

and education; but this is also time-consuming and costly. Some employees, however, have already learned good English. Financing is available in the local market but interest rates have been very high due to high inflation levels. The currency has become stronger with the establishment of the new currency and the new monetary policy. Working capital is financed from local sources, but other necessary investment was financed from sources in the West.

Companies from the West such as Unilever and PLM import goods, which make more goods available on the Polish market. These activities make the market more active by changing customer behavior and supplier-customer relationships. PLM also works with other investors from the West with different business traditions as well as experiences that contribute to change in the local market. The role of foreign suppliers and customers helps local people see things from a different perspective than they are used to. Their activities have a chain effect on their respective networks. They do business in their usual way and this promotes and contributes to change.

### **6.3. The Bulten Tools Share Company in Poland**

The Bulten Tools Share Company (BTSC) is a public company listed on the Stockholm stock exchange and has three major operating areas. The major areas deal with the automobile industry, general industry producing screws and stainless material, and the electronics/telecommunications industry. BTSC's net sales were 1 billion Swedish Crowns in 1997 and 1.1 billion SEK in 1998. It has sales offices and warehouses in Sweden, the U.K., Germany, France, Holland, and Spain. It carries out production in Poland, China and Germany. All the factories and sales offices are fully-owned companies, except in Poland where BTSC owns 93% of the shares. It also intends to take over the Polish company fully.

#### ***6.3.1. The Initiation and Motives for Forming the Alliance***

BTSC entered Poland for four reasons. First, production costs were lower due to cheap labor. Second, its customers from the automobile industry were moving into Poland and it thus had to follow them to continue as a supplier. A company can produce one car model in several locations all over the world, but if it can't deliver all parts to all those locations, it will not be considered a serious supplier. In today's rapidly changing international market, suppliers need at least to be European today and global tomorrow. Thirdly, there was a

large domestic market for BTSC's products. Finally, there was considerable potential to generate revenue. Both sides had been in contact previously. A Polish company, the Eleventh National Investment Funds (ENIF), sought to form an alliance with BTSC. The local partner was interested in BTSC and took the initiative as it was in need of a strategic investor, not only a financial investor. It needed someone who could supply the appropriate technology, capital, and had the right contacts in the automobile industry. The local partner had the screws factory in Poland and realized that the company could not develop it by itself. It needed a partner to upgrade its technology, to provide the necessary capital, and finally to find a market for the alliance products.

### ***6.3.2. Negotiations***

The local Polish partner contacted BTSC in October 1997. Thereafter, about ten meetings and negotiations were conducted, both in Sweden and in Poland. The main focus of the negotiations was to formulate the contract, determine the value of the company and decide the price. Despite many meetings, it was a very rapid process, and after just five months, a contract to acquire the company was signed in February 1998. Government permission was required for this takeover, and that took another six months. BTSC signed the contract with ENIF. There was no requirement for a negotiation with the government, but the time required for the permission was part of the bureaucratic process. The application had to pass through the Ministry of the Interior, the Ministry of Defense and the Ministry of Agriculture. There was no conflict or misunderstanding; it was just the process which took time.

The main negotiators were the Chairman and President from BTSC and, on the Polish side, two representatives from ENIF. Fifteen National Investment Funds were set up in Poland to carry out privatization. BTSC bought the majority shares from the Eleventh National Investment Fund. According to the agreement, BTSC owns 93% of the JV and the rest belongs to ENIF. BTSC treats the company as a fully-owned subsidiary and its final aim is to acquire ENIF's shares. The local partner is only a financial investor and does not have much influence in the company and is almost ready to surrender its ownership to the foreign partner.

### ***6.3.3. Resources***

BTSC is responsible for management, technology, financing, marketing, quality control, and purchasing basic production materials within and outside

Poland. It applies an integrated purchasing approach that also includes the purchase of goods for other subsidiaries. Steel, which has been a basic input, is bought on contract for supplying BTSC's subsidiaries in Europe. It trains the local manpower to take responsibility for the marketing in Poland. Local employees are in charge of sales in the Polish market. However, BTSC has responsibility for marketing and sales in West Europe. Moreover, BTSC is also responsible for the training and competence development of local technicians and production-related people. In production, BTSC applies its production control and production technology, in addition to being responsible for technical and product development. R&D is also an area of its responsibility.

BTSC does not currently obtain any more help in its government relationships, but it received much support from ENIF during the formation of the alliance. The local partner handled all contact with the government. During the transition period, i.e. from the signing of the first contract till BTSC obtained all its permits, ENIF helped a great deal. Without the direct help of ENIF, the process would probably have taken much longer. Getting the permits was NIFs' biggest contribution to the alliance.

#### ***6.3.4. Learning***

BTSC has learned that running the operation successfully and introducing change in markets like Poland takes much longer than one anticipates. That has been a big lesson. The other aspect of learning is the language problem that makes things difficult in unfamiliar and different environments. BTSC has even learned what makes its operations better and easier to perform. It knows now how people think and how to approach them. It has even learned how it should bring over a basic message to ENIF that makes its operations much easier and more effective and to obtain results much more quickly than in the introductory phase. On the other hand, ENIF was not interested in learning. It was interested in good company performance so it could secure a better price for its shares when selling them. It owns only 7% and has not been actively involved in operations. Of these shares, the Polish government owns 3.5% and about 60 private investors own the remaining 3.5%.

However, at the present time BTSC does not want to buy the shares owned by ENIF. This is a matter of the company's policy. ENIF has also learned to trust BTSC. ENIF was to a certain extent suspicious at the beginning — almost all involved trust BTSC now. Initially, ENIF thought that BTSC would just come in and take the money. ENIF employees thought a productivity increase

would mean they would lose their jobs. The local people assumed that when the change took place, many of them would be laid off. They thought that BTSC came to Poland to corner the market and close ENIF. They saw other Western companies entering Poland, and instead of upgrading production, they closed the companies and started importing to sell in the Polish market. As a result, many people lost their jobs. This experience created some obstacles to carrying out changes during the introductory phase. In due course, however, it became easier to introduce the changes, as BTSC gradually earned people's trust.

### ***6.3.5. Network***

BTSC did not obtain any help from ENIF to develop other contacts in Poland. However, BTSC has developed several new contacts in Poland by its own initiative. Recently many car producers have entered the Polish market and are in need of different components and related products from suppliers. BTSC already knew some of these manufacturers and has already been selling some products to them. After the entrance of these companies in Poland, BTSC has come into contact with them. Specifically, it had close contact with a company, Auto Live from Sweden, and some companies from Germany. These companies are now active in Poland and have already developed customer-supplier relationships with BTSC there. BTSC supplies these companies mainly from its production in Poland. However, it imports some components for the buyers if they are not produced locally.

### ***6.3.6. Performance***

BTSC claims that it is satisfied with the results achieved, although these took longer than what it assumed at the beginning of its operations. The company does not assess its results in solely economic terms. First, the way it managed change was successful. Second, the company could be changed in a short period. Third, the company's belief that its customers would enter the Polish market rapidly, has been realistic as many have already entered or are on the way to entering the market. BTSC is happy that the forecast is holding. Initially, BTSC followed some of its customers to Poland and other customers are now also entering the market. It is an interactive process. Further, BTSC has increased its sales and market share, both of which have been the basic motives

of BTSC in choosing Poland. It has been successful up till now and considers the market to be very promising in the near future.

The current ownership structure is not at all a problem to BTSC, as it does not really matter whether it owns 93% or 100%. This is purely a financial matter, i.e. how much it should pay for the remaining shares. BTSC's long-term aim is to own the alliance fully. However, since the company is a major owner, it has full control of the operation and the other minority shareholders just follow its decisions and policies. BTSC doesn't exactly know whether the Polish partners are satisfied with the results achieved or not. Some are not satisfied, because they want BTSC to buy the shares for an extremely high price, irrespective of the results achieved so far.

The most positive result that BTSC has experienced concerns its successful entry into the Polish market. It now has a sound base in Poland that can be used to operate in Eastern Europe successfully and consolidate its position in Western Europe and other parts of the world. It is building up its management in Poland, with people possessing knowledge which BTSC didn't have, especially about Eastern Europe. These people can be used as a bridge or a stepping stone to Eastern Europe as well as to other countries.

Another positive aspect of the JV is the cooperation that BTSC has developed with the labor unions. The labor unions were extremely open and fair in their discussions about changing the company and laying off people. All these issues were settled around the table through discussions and negotiations. Strikes or other similar problems were expected, but BTSC has not experienced such things. The labor unions listened and were receptive; they took part in the decisions and contributed many positive things. They have been very helpful throughout the process of change. The labor unions are convinced that BTSC can really contribute both to the company and the country. They have a long-term perspective that helps BTSC to restructure and formulate a competitive strategy. The major disappointment in the alliance has been the language: this has sometimes made things difficult and confusing.

If there was an opportunity for new investment, BTSC did not think that it would establish other alliances with local partners. Considering its past experience, it stated that it would be better to establish a fully-owned company, as it is easier to control and is more efficient. Majority ownership, at least, is required to operate in Poland. It would never recommend another firm to go into Poland with a minority shareholding. It would be very difficult to control such an operation and to contribute anything other than financial help. And by financial support alone one cannot do a great deal because the Polish partner will stick to the old strategies; it will never develop the company. The overseas partner will have to pay for the losses. BTSC believes that the local partner will

maintain the number of employees and pay them even if they are not productive.

### ***6.3.7. General Environment***

The main cultural obstacle was the language. In Poland, people do not speak English, which is BTSC's business language. The local people are educated in Polish or Russian. BTSC inherited a company with 525 employees, of which only five could speak English. It attempted to handle the language problem successively: in the short term by using interpreters, in the medium term by teaching English and in the long term by employing a new management that commanded the language. The use of translators solved some temporary problems. The second step was more difficult as well-qualified people were required to teach company business policy and to upgrade the language. After 15 months of training and education, BTSC noticed that it was possible to communicate with some employees. But communicating with the customers in the local market has not been a problem at all because specifications used in the automotive industries are international, and the customers are familiar with English as they usually use it as the official language. As the third step, BTSC has employed an English speaking local manager, with the help of an American HRM company. The recruitment process took 15 months resulting in the appointment of a financial director. It was difficult to find such competent people locally, because there is high demand for such people. This manager speaks English, knows the Polish bookkeeping and tax laws, and is familiar with Western controlling principles.

There is also another major cultural difference that BTSC came across. The state planned economy taught people to think in a way that is different from that in the West. People learned that someone else planned for them and they had to achieve certain targets. The concept of marketing or sales did not exist in Poland before 1990. The producer had to deliver a certain quantity of a product to customers. This was decided in Warsaw or elsewhere. Delivery was not based on customer needs. This was an obstacle, as BTSC had to teach people to think in a different way. The problem still exists, as it is a country which experienced a communist rule for 50 years. BTSC has started to introduce Western management styles, which cannot happen in a day. Teaching local people and changing their ways of thinking and understanding has seemed to take a long time. This is a costly process as it needs to be done continuously through on-the-job training including quality control, language and knowledge of environmental management.

When foreign investors enter Poland they have to enter into a *Social Contract*, which specifies the conditions on how a company will treat its employees during a certain period, and includes a promise to respect the Polish language and the labor union. BTSC had to guarantee wages for 12 months from the date it took over the company. One does not have to guarantee work because employees can get paid for 12 months and can leave the company. Based on its agreement between the labor unions and local management, it laid off a number of employees from 525 to 370. BTSC's aim was to increase productivity and close certain sectors of production. According to the social contract, BTSC has to use Polish as the official language of the alliance. English is used as a means of communication among the owners. Due to employee morale and work discipline, people prefer to delegate upwards. The boss should take the decision: workers think they will be penalized if something goes wrong. The whole system is bureaucratic, and in a bureaucratic system people are made responsible when they make mistakes. If one never takes any initiative, one will never make any mistakes. That is a typical *state planned bureaucracy*. It becomes very difficult to create a spirit of teamwork. In the West, people often work in teams when solving problems and taking necessary corrective measures.

There are opportunities to borrow money in Poland for financing projects as many international banks operate there. But it takes a long time to get loans sanctioned and interest rates are consistently high due to high inflation. The Polish currency is continuously devalued due to the high level of inflation. The government still has a central role on monetary policy. Legislative aspects and government policy make both the import and export situation complicated. Administrative processes are slow because each document has to be negotiated. A Polish customs officer takes commission on the raising of duties by the government. At present, customs employees do not have a full salary — 2/3 is paid as a fixed salary and 1/3 as commission. They thus try their best to raise the amount of duty paid by importers so that they can proportionally get a higher commission. This affects BTSC's operations as it takes a long time for customs clearance and the company has to employ extra people — this results in high production costs. The other impact is that bureaucracy delays production and delivery. Although the initial aim was to select a low production cost country, the result is turning out to the contrary. However, one has to accept this while entering a low cost country, because productivity is much lower there; but this will soon change and staff in the customs department will have a fixed salary. Consequently, the situation will improve. There is no major difference between the technology used in Poland and that used by

BTSC. The main difference is in the work procedure applied around the technology.

## **6.4. Svedala in Hungary**

Svedala Industry started to operate in Sweden in 1990. Its major areas of operations involve the maintenance of pipeline, equipment, and starters to the mining and mineral processing industries. Svedala's sales in 1999 were around 14 billion Swedish Crowns, slightly less than those of 1998. During 2000 the company estimated about 4–5% sales growth. The total number of employees is 10,500. Svedala is owned by several finance companies. Custos Investment Company in Sweden is one of these, owning 12% of the shares. During the build-up phase, Svedala was involved in licensing arrangements but its philosophy today is not to get involved in licensing or JV as they are resource-consuming forms of operations. It solely wants to run fully-owned companies. It is currently trying to terminate as many as possible of the existing JVs and licensing agreements.

### ***6.4.1. The Initiation and Formation of the Joint Venture***

Ilona Tattai, managing director of Taurus Rubber Company (TRC) in Hungary, contacted and asked Svedala if it was interested in operating through a JV in Hungary, during the Communist period. Ilona was a politician interested in developing personal kudos. Her aim was to gain political favors by developing collaborative links between the company she was managing and a well-known West European Company. During the old Communist era an iron curtain separated the West from the East and few JVs operated in the ECE countries.

Svedala was ably assisted by the Hungarian Embassy in Sweden in establishing the JV. The Hungarian ambassador visited Svedala and conducted an intensive discussion with the manager then in charge of the company's Rubber Section. The Swedish embassy in Hungary was also involved in this JV initiation and formation process. For its part, Svedala was also interested in having some operations in the ECE. It believed this opportunity could be a platform for establishing and expanding business within the old ECE countries. Two years later the iron curtain fell and the ECE became an open market. Svedala had no alternative than Taurus in the formation of an alliance. Thus, a 50–50 JV was formed.

An interesting discussion ensued wherein it was easy to get to the main points at issue and to conclude and sign an agreement. The local partner was

interested in being one of the first in Hungary to establish a JV with a Western company. As both parties were interested, the negotiation was concluded rapidly. There was no conflict or misunderstanding in the negotiation. The local Hungarian partner was very reliant on Svedala. When the JV started, Svedala was in the driving seat in the board meetings. It had more experience of running a company in a market economy, in contrast to the competence of those in the East. According to the contract, Svedala had to supply product and computer know-how, business systems and computers to the JV.

#### **6.4.2. Motives**

Svedala wanted to get a foothold in the old Eastern bloc. At that time there the iron curtain existed and Svedala wanted to have a stabilized set-up behind it. In many respects, the Hungarian market was a springboard to other markets. Svedala had considerable business in Russia, Poland, and trade relations with various companies in the ECE. The local partner was the only rubber company in Hungary. It was a state-owned company and was a major player in the rubber business, especially in tires, conveyer belts and some other related products. Besides the personal interest of the managing director, TRC's main interest was collaboration with a Western firm in gaining access to modern technology and market know-how.

#### **6.4.3. Resources**

Svedala was expected to transfer knowledge of modern marketing and information technology through computers. Its main contributions consisted of production, design and management know-how, and R&D. It was also partly responsible for marketing. Svedala has established a service station in the premises of the company with its personnel and service cars ready to provide the necessary marketing services. TRC produced Svedala's products in Hungary for the ECE market. TRC was responsible for production and the JV performed the marketing function. It obtained a license for producing Svedala's products in Hungary. In fact, Svedala had both a JV and licensing agreement with the local partner. This form of cooperation was needed as it was very difficult to produce in Sweden and export to the ECE countries. It was also cheaper to produce in Hungary than in Sweden. The labor and the material costs were cheaper. Due to trade relations with Russia, the JV could buy the main raw material — rubber — at a very low cost. Efficiency was not as high

as in Sweden; however, total production costs were lower in Hungary. The local partner had also contributed its local market knowledge, production facilities, and was responsible for materials procurement. In sum, the local partner had the production infrastructure.

Both partners made equal financial contributions. Svedala was in the driving seat and TRC was more or less a follower. It ran the JV from board level as if it was its own company. Throughout, TRC listened to Svedala's advice and followed its instructions, and both parties could have an open dialog.

#### **6.4.4. Learning**

When TRC was fully responsible for marketing, it just sat and waited for telephone calls from customers. Svedala introduced the local partner to the push strategy that it had to go out to the marketplace and take offensive measures. Moreover, it taught the local partner to give a round-the-clock service to the customer in order to be an efficient marketer, not just sell products. By applying marketing know-how it helped TRC start selling its products efficiently and take the responsibility for customer contacts.

Svedala learned that TRC had many contacts in the old ECE countries. It could procure products manufactured by TRC for selling in the West at a very competitive price. It further bought some raw materials, also at lower cost, with the help of TRC and the JV from Hungary for usage in Sweden. The JV helped Svedala to acquire new markets and higher market share by offering low cost but quality products.

Most of the economic terms used in the West, were not in use in Hungary and the other ECE countries. As a result, it was difficult for the local partner to understand Svedala, as it was not familiar with the Western economic, financial and marketing terminologies and concepts. The local partner has since gradually learned all these financial terms and concepts. TRC has learned a great deal from the JV. TRC became a modern company in regard to production and marketing. It learned how to operate computers, and to manage and control a company better. It also learned production technology that it is still using in production. Svedala believes that it upgraded the local partners' competence in all fields. This learning has made the JV more efficient.

#### **6.4.5. Network**

The JV helped Svedala to strengthen its network further and to develop new contacts. In Hungary it has become acquainted with many influential people:

ministers, politicians, several banking people and governmental authorities, who play essential roles in all spheres of society. The contact with the Hungarian Ambassador is a good example. This relationship was helpful in developing contacts with the banks, authorities and other important institutions. Through its experience and learning in Hungary, Svedala managed to develop contacts and to establish its companies in Poland, Slovakia, and the Czech Republic.

Svedala has also helped TRC to develop contacts in Sweden and other West European countries. It has good contacts with a factory supplying conveyer belts and helped the Hungarian partner to obtain good supplies and better prices from a Dutch company, Ananca. TRC also developed contacts with Solidur, a German supplier of low friction materials. These are the two essential contacts that Svedala helped TRC to develop. The local partner still utilizes those two contacts. Svedala buys products from TRC to sell them further and provides TRC with customer contacts. Svedala also procures materials and components from TRC for manufacturing in Sweden. The finished products are sold in western European markets.

#### ***6.4.6. Performance***

Both partners succeeded in building up a rather good company, which grew from a very weak to a healthy position. However, the JV was sold in 1997 to a German firm at a very favorable price for the partners. Svedala intended to buy the JV. The main reason for selling the company was because the government wanted to privatize the state-owned companies. Svedala could not buy it as the price paid by the Germans was four times higher than what Svedala was prepared to pay. Svedala lost the bid, otherwise it would have bought the company. There was an opportunity to form a JV with the Germans who even proposed Svedala to make such an alliance. But as the Germans were paying a very high price for the company, Svedala realized it would get a higher price for its 50% of the shares it owned. Consequently, it chose to sell its shares rather than to continue in a JV. Svedala considered later on that it was a mistake not to buy the JV. If it had bought the JV it would have developed a very strong position in Hungary with a local presence in the market. It has earned very good revenue by selling its shares but lost its position, which might have been developed in Hungary and the neighboring countries.

The performance of the JV is considered to be a success by Svedala as it learned a great deal. Moreover, it also developed good contacts, which it can still utilize and even the former joint venture remains as one of its important

suppliers. The other measurement of success is that it managed to build up a JV, which was worth much more than when it was started. As a result, Svedala earned a good profit when it sold its 50% shareholding.

The JV was also successful for TRC as Svedala taught them how to manage and control a private company. They have learned production know-how, marketing know-how and how to provide the necessary and satisfactory services. TRC is also satisfied due to the fact that Svedala is still a big customer of its products. Svedala enjoys a high turnover for the products it buys from TRC and sells in western European markets. Conclusively, it can be said that both Svedala and TRC are satisfied with the results achieved through the joint venture.

Before the iron curtain fell, Svedala personnel established very close personal contacts and social bonds. As Svedala managers sat on the board of the JV for more than ten years, they managed to develop excellent contacts at all levels. Both partners developed good relationships as they worked at board level together. These contacts are still alive at the personal and company level. Not only does Svedala buy several products from TRC, but it also uses the latter as an intermediary to sell its products to customers in Hungary. Svedala sells to TRC and TRC in turn sells to its customers.

#### ***6.4.7. General Environment***

The attitudes of the JV partners towards investment and the concept of the market economy were different. The biggest cultural difference between the partners was that the Hungarians had difficulty in understanding how the market economy functions. This is a difference in the language of the market economy. The other economic difference was that TRC could not understand the economic concepts and terminologies that were used by Svedala. However, the Hungarians were very open, and both parties could learn and interact with each other quickly.

The organizational structure in Hungary was also very centralized, but the JV developed a decentralized structure. The Hungarians adapted to the new structure very rapidly and the Hungarian managing director had several years of working experience from a number of countries. So he could have a more open attitude relative to the other local people. He quickly became acquainted with Svedala's way of thinking and doing things and introduced it to the rest of the organization in a short period of time without any difficulty. As the JV adopted decentralization, there was no organizational problem at all. There were some language problems at the lower management level. However,

according to the managing director there were no serious misunderstandings that could make the operation difficult. At the board and top management level, communication went smoothly.

The JV had access to local sources of financing. Svedala invested its own money when it started but later the JV was financed by borrowing from local sources. The local loans were granted on reasonable terms and conditions. The authorities were helpful all the time and the Hungarian government has had a clear understanding on how to proceed to come close to the West. It stands first in the queue to join the European Union. As to economic development, Austria could have a considerable impact on Hungary. However, it is now believed that little difference exists between doing business in Hungary, Poland, and the Czech republic as they have become more or less familiar with Western business practice. During the planned economy era, local companies were buying on an annual basis and produced at high volumes. Svedala also followed the same tradition. But today there isn't that much difference, especially in Hungary, as things have changed drastically there.

## **6.5. Getinge in Hungary**

Getinge is a medical engineering company, which produces and sells sterilization and disinfection equipment for hospitals, pharmaceutical industries, research institutes, etc. It also has another business area, which covers health care and elderly care. The company's net sales during the last four years, (1996–1999) were between 3 and 5 billion Swedish Crowns. It has 3,800 employees working around the world. The company is owned by Getinge industries (GSC) which claims to be one of the world's largest companies operating in the medical engineering field. GSC owns production facilities in England, France, Germany, the U.S.A, South Africa, Australia, Italy, and Holland. It has 80 companies in 22 countries and distributors in 19 countries. It has a fully-owned sales company in Poland. In Hungary it operates through a JV by the name of HG Medical Instrument Ltd.

### ***6.5.1. The HG Medical Instrument Ltd. (HGMI)***

HGMI conducts marketing, sales, installations and other services in the medical engineering field. Its turnover is approximately 15 million Swedish Crowns per year and it employs 18 people. The local partner, Mr Onody, owns 80% of the shares, the rest being owned by Getinge. Before buying the shares

in 1990, Getinge had been collaborating with the local partner for more than 20 years. At that time the local partner represented Getinge in the Hungarian market. When the new company was established in 1991, Getinge obtained its shares in the company. The alliance only deals with marketing and services and does not involve production. Getinge is responsible for product development and production in Sweden.

### **6.5.2. *The Initiative Behind the Alliance***

As it was neither easy nor convenient to operate in the ECE markets during the socialist era with a fully-owned business entity, the Swedish Trade Office in Budapest represented Getinge. It was also very important for a foreign firm operating in the local Hungarian market to have a local service organization. Consequently, Getinge contacted Mr. Onody who had been working with a group of service engineers. The group was winning contracts from a state-owned building company (FEMV), which was not allowed to have direct contact abroad. The group of engineers in turn had to go through an import company by the name Medicor. It was a big company operating in the medical field and had permission to deal directly and sign contracts with foreign firms. As a result, many contracts were signed between Getinge and Medicor. Due to such arrangements, Getinges could smoothly operate in Hungary with the active help of the group of engineers.

When Medicor pulled out of the relationship, the contracts were signed directly between Getinge and the state-owned building company FEMV. Before 1989, FEMV was not allowed to sign contracts with foreign firms. It was an umbrella company of Getinge's service organization from which all services were provided to local customers. In fact, Mr. Onody and his group of engineers were working for Getinge and offering services under the auspices of FEMV. However, following the fall of the Berlin Wall, Hungarians were allowed to form private companies and to deal with foreign firms. This opportunity made Mr Onody interested in setting up his own company where Getinge could step in as a foreign partner.

In fact, it was Getinge that took the initiative to form the JV with Mr. Onody and his company, because it was in need of providing customer services in Hungary. The first step in forming a JV was taken in 1977–1978. The negotiations which then took place between FEMV (through Mr. Onody), Medicor, and Getinge consequently resulted in a collaborative arrangement. But the real opportunity of forming an alliance came when Mr Onody could start on his own in 1991.

### ***6.5.3. Negotiations***

When HGMI was established, Mr Onody offered Getinge 20% ownership in it, an offer accepted by Getinge. Getinge was not interested in owning more than 20% or a majority shareholding in the JV at that time. But later it found that 20% ownership was not enough, given its activities in Hungary. Things have changed in several respects. First, Getinge ARIO, a subsidiary of Getinge involved in elderly care, has been operating for several years in Hungary through a local distributor. It seems more practical for Getinge to do everything under one company. Second, it has to rationalize its operations. Getinge already has a sales company in Poland and representatives in the Czech republic, Slovakia, Rumania, Bulgaria, and Albania. All those countries are neighbors of Hungary, and therefore, Hungary can very well be the center of operations in the ECE. One of the main reasons that Getinge has wanted to centralize its activities in Hungary is because most of its operations are now conducted there. Getinge believes that its relationship with the independent distributor of ARIO will affect its cooperation with Mr. Onody in a more positive way. It wants to bring these activities within the JV and gain a stronger position in the operation. These issues have been discussed at top management level in Getinge which is keen to proceed with the ideas.

Getinge has already started negotiating with Mr. Onody to increase its shareholding in the JV. For his part, Mr. Onody is expecting Getinge to come up with a suggestion on how much value it puts on the shares it intends to buy. Getinge believes that Mr. Onody is interested in selling some of his shares. Whether Mr. Onody will accept Getinge's majority position or not seems to depend on how much Getinge offers to buy the shares.

### ***6.5.4. Motives***

For Getinge, the purpose of forming the collaboration was to provide a good service to its customers in Hungary. Getinge had to set up a service organization to provide services to sterilizers and disinfectors. It was not that difficult to sell, but Getinge needed an organization to take care of its products, do the installation, and provide other related services. Since HGMI was established, it had started to take care of installation, services, marketing and sales in Hungary. Getinge was interested in selling and keeping its customers satisfied with a good organization for services and after sales support. Of course, earning money, and increasing its activities and market share in Hungary were also important objectives of Getinge.

### **6.5.5. Resources**

Getinge is responsible for the production and delivery of machines that are marketed by the JV. The latter also takes care of customer contacts and services. The Hungarian partner provides technicians and production-related people for installation of machineries and other support to customers. Getinge also provides the required manpower, especially technicians and production related people whenever necessary. If the local partner faces some technical problem that it cannot solve, Getinge sends its technicians and production people to Hungary to identify and deal with the problem in an appropriate way. A concrete example occurred when some washer disinfectors were not functioning and customers were dissatisfied with their performance. HGMI tried several times but failed to identify and solve the problem. Finally, HGMI reported the problem to Getinge. Getinge sent a service technician who investigated the problem and discussed the issue with the people in charge of the service in Getinge's disinfection factory in Sweden. It was discovered that the machines supplied contained faulty instruments in the control unit. New parts were sent from Sweden along with production people who replaced the defective instruments.

### **6.5.6. Learning**

Both parties had an ambition to learn from collaboration. Getinge learned that the country was lagging behind in its technical development of the hospitals. It also claims to have learned how the market functions, the marketing system as well as market trends, the local culture, the financial situation, technological developments, the technical level, government policy in different areas, and government regulations in general. It learned from its customers how the technical field in the hospitals functions. This has made it possible to adapt its products to customer needs. For example, its customers don't have as many operation instruments relative to those used in Sweden. What Getinge has learned is not to offer as many machines to the sterilization departments in Hungary as it offers in Sweden: it tries to limit them so as to focus on solving real needs.

The Hungarians have learned that Getinge's sterilizers and disinfectors are of high quality and Getinge provides a good service with a good name. The partners' mutual learning has had a positive impact on the performance of the JV. Both partners now have a better understanding of their capacities and needs which has had a positive influence on the alliance. Getinge regularly educates

the local partner's employees. It conducts courses for service personnel and for sales personnel where it teaches sales techniques and presents new products. It also takes up various sales problems with the course participants. The local people obtain a clear idea about the product and production development in connection with the training of the service personnel and salesmen. Direct association with the personnel from Sweden has increased the sales and service competence of the local people.

#### ***6.5.7. Network***

The JV has helped Getinge develop a network in Hungary. Getinge developed contacts with several customers and other companies engaged in importing and exporting. It has full access and full correspondence with them. Both parties rely on each other and have enough trust and understanding of each other's capacities and operations. Mr. Onody provides the list of the companies, which can be of interest to Getinge. Getinge had contacts with Medicor before developing the contacts with Mr. Onody. However, it subsequently developed contacts with FEMV and many customers through Mr. Onody. At present it deals directly and indirectly with those customers. Some of them buy directly from Getinge. To avoid the problems of customs clearance, most customers in the local Hungarian market buy through the JV. It is too bureaucratic to fill out the papers and to clear the goods: this creates a good deal of work. So collaborating has arguably helped Getinge develop several new contacts with various customers.

Moreover, through its local partner, Getinge has developed contacts with various governmental authorities and officials. Being successful with his company, Mr. Onody gained a certain degree of influence on government officials and authorities. A concrete example is that it has developed contacts with the authorities that issue import licenses for equipment. These authorities have been in Sweden several times to visit Getinge and Getinge has also visited them several times. Such contacts have improved Getinges' operations. For example, in order to obtain a Pressure Vessel License (pressure vessel is a kind of sterilizer), Getinge needed to pass a special test and get a certificate. When the application was submitted, the authorities checked Getinge's production facility and were satisfied with the tests. The relevant authority has now issued license in a very short time relative to how long it used to take. Getinge has also developed contacts with the Ministry of Health to which it has presented its products and services. The Ministry has expressed its satisfaction that Hungarian customers are dealing with serious suppliers that can provide high

quality products and services. The Ministry also helps Getinge by recommending Hungarian customers to buy from Getinge. The Ministry also provides all the necessary help to Mr. Onody, which again assists the smooth and successful running of Getinge's operations.

Getinge has also helped the local partner develop some new contacts. It has presented and introduced Mr. Onody and his company to producers of the other equipment in its major medical device. Manufacturers of product indicators are a good example of this. An indicator has to be inserted in sterilization equipment for it to be of the right quality. These indicators are mainly produced in England and Getinge has helped the Hungarian partner come into contact with those producers and their representatives. The local partner was also introduced to Electrolux Kitchen Equipment, a Swedish company: this relationship has been very useful for the local partner.

#### ***6.5.8. Performance***

Getinge claims that the JV was very successful and has achieved its objectives. It had seen high sales, provided good services, had a good reputation, and developed good connections with customers and the authorities. Mr. Onody and the HGMI are also satisfied with the results achieved by the JV and have declared on various occasions that they are satisfied with the performance of the JV. After twenty-two years of cooperation, the partners have become very close friends with well-developed social relationships. Getinge would like to continue with the collaboration, because it believes that the local partner is the best it can find in Hungary. If the opportunity arose, Getinge would be willing and ready to establish another Joint Venture with its Hungarian partner.

#### ***6.5.9. General Environment***

Hungary's social life is well developed and the people are very loyal and friendly. There is an extended family system in the country. There are some cultural differences between Hungarians and Swedes. However, the differences are much smaller than the difference between the Swedes and the Poles. The Hungarians are similar to the Swedes and the cultural differences are very narrow. The Hungarian language is difficult. However, it does not create any problem for the JV as all communication is in English and German. Most people working in the JV are either proficient in English or German.

There is some difference in the concept of time. Getinge does not consider it as a problem although there are differences in efficiency, punctuality and initiative taking at different levels of the organization. Those who work in the international market, such as in sales, have accepted the Western business style. On the other hand, there are also older people who worked for years under the Communist era. These people are not at all aware of the Western management style, and for them, there is a real difference. If a Hungarian company operates in the international market it does not employ people with an old way of thinking. The Hungarian decision-making process does not affect the operations of the JV as they are rapid decision makers. Essential issues are discussed thoroughly; the employees take care of each other and share information in a professional manner. This has a positive impact on the operation of the alliance.

The legal aspects and government regulations affect Getinge's operations in several ways. The company is dependent on import licenses, customs, VAT, and governmental budgets. The government has adjusted considerably to the requirements of international business. To give a concrete example, it applies a reasonable percentage of VAT, and cooperates with Getinge to facilitate easy acquisition of import licenses for their products. There is no importing problem as Hungary has been adapting to EU regulations. Hungary was among those countries that had the most contacts with the Western European countries during the Communism period. It is more Westernized than the other ECE countries and no longer a good representative of the ECE.

The major problem of the JV is the financial constraint, i.e. the small budgets of the hospitals buying Getinges' products and services. They are granted very limited funds and the government is decreasing their budgets. They are reliable customers and good payers, but at the same time they are also late payers. If a hospital needs a new sterilizer, it applies to the government so that the funding will be included in the budget. Once approved, the budget is normally financed by the County Council. It is the City Council that administers the budget. The local partner also provides services, spare parts and accessories. He is paid directly from the hospitals because they have a certain budget for operating costs. Mr. Onody claims that customers pay late. He has a considerable amount of accounts receivables for the hospitals.

HGMI requested Getinge to help with the arrangement of financing. Mr Onody has close contacts with a local leasing company in Hungary, but neither credits nor leasing are favored. These cost too much and explain why cash payment is preferred. Getinge attempts to help them overcome their financing problems by proposing credit opportunities from the various credit institutions in Sweden. Getinge has made offers but the local people have decided not to

use the credit but to pay in cash. Getinge assumes that pride can be one of the main reasons for rejecting the proposed offer.

#### ***6.5.10. Customer Relationship Management Since 1989***

Getinge and the local partner often visit the Hungarian customers together. Moreover, the customers are also invited to Sweden to observe Swedish health care. This has created a close relationship with customers. However, prior to 1989, Getinge and its customers were not allowed to have direct contact. Everything was centralized. Getinge sold equipment first to Medicor and then Medicor delivered it to the customers. There were no direct complaints although there were certain disadvantages of the indirect customer-supplier relationships.

The biggest problem was that of sterilizers that needed to be adjusted to specific customer needs. As the supplier-customer relationships were indirect, not all customer needs were taken into consideration by Medicor. Getinge did not have enough knowledge and information about its customers and their needs. However, since 1989 the situation has changed and Getinge has been dealing directly with its customers. This has resulted in a better customer relationship management because Getinge's speciality not only concerns selling products. It also suggests to the hospitals as to how they should equip their central sterilization departments. The hospitals send in building drawings to Getinge with plans for a number of hospital beds, operation rooms and number of operations to be conducted, for example, per year. Based on this information, Getinge makes a suggestion as to what and how much equipment they need. Before 1989 providing such a service could not work to the extent it is doing now. The change has a positive impact on its relationships with customers and the degree of their satisfaction.

Getinge arranged two big international exhibitions per year in Hungary where customers were allowed to visit and observe how it operated. These were the only two occasions the customer discussed with Getinge directly before the change. However, since 1989 customers have had the opportunity to travel to Sweden and present their case at any time. This has resulted in much better communication with Getinge. The new communication process is improving the quality of the service. The rate of complaints is difficult to compare, as there was no right to complain before 1989. But now the customer has the right to complain if something is wrong.

Getinge's responsibility is to produce quality products and come up with good suggestions. Compared to the period before 1989, Getinge does not

provide fewer services. This is because firstly it has more equipment now and, secondly, Mr. Onody makes contacts with the hospitals for monthly or quarterly surveys. As a guarantee, Getinge is taking care of sterilizers and providing the necessary services. The local partner visits the customers regularly.

## 6.6. Nordic Ekofiber in Poland

Nordic Ecofiber (NE) is a family firm and the family of the managing director (MD) owns 80% of it. The firm employs 12 people in total who work in two factories and some are engaged with the marketing function. NE collaborates with contractors which means that it has to deal regularly with more than 100 people. The contractors are the buyers who install ecofiber in the walls and the roofs of houses. NE has an active client support function and a distributor of its products. The function of NE is to develop, manufacture and keep contact with universities to further develop its products. The company mainly does its technical development in-house. The distributor works exclusively with NE products. But normal clients also use rockwool products, a substitute for the ecofiber. The product ecofiber is a cellulose fiber used for insulation in the construction of houses. Ecofiber is made from recycled paper and boron salts. Its main characteristic is that it is an ecological product and neither itches nor is harmful to humans. The material has been used in the Nordic countries for 20 years.

The total sales of the firm in Sweden were 15 million Swedish Crowns in 1999. NE had the same sales volume in 1994 but afterwards it fell drastically due to the recession in the construction industry. This was an important reason for NE to seek other markets. As to export markets, Norway stands culturally very close to Sweden and NE's export activity functions quite well there. But the company has certain problems in Denmark, as the country has a policy of protectionism. Although there is considerable bureaucracy in Germany, it has a good understanding about Swedish products and the Swedish system.

### 6.6.1. *Establishment of the Joint Venture*

A Polish professor, who used to visit Sweden on his vacation during the late 1980s, liked the Swedish mentality and learned Swedish by himself. He came across the NE factory in Northern Sweden and found the product attractive for the Polish market for its simplicity and lower price. He talked about the product

with his friends in Poland to make them interested in it. The MD suddenly received a letter and a telephone call from the Polish professor. The MD went to Poland in 1991 and met the Professor's friends there. The negotiations took a couple of years and a joint company was established with some local partners. In the beginning, NE management had the idea of selling the license to a Polish company and earning a royalty. But the MD soon found the local culture exciting and the market very attractive, he therefore wanted to invest in the country. He thought an establishment in Poland would be helpful for exporting and further expansion in the East European countries. A factory was established in Kielce, Poland, in June 1994. Production also started in the same year. Kielce is 180 km from Warsaw.

Eighteen people worked in the Polish company. The sales volume of the Polish factory was 10 million Swedish Crowns in 1999. In the beginning, there was a local liquidity problem. To solve this, Swedfund International came into the picture. Swedfund agreed to finance the JV if they had ownership and some authority in the collaboration arrangements. NE, together with Swedfund International, owned 55% of the shares of the company. NE had 34% and the MD of this Swedish firm functions as the chairman of the Polish joint venture. Swedfund's shareholding was constituted of cash only, which was primarily used for investment. Initially, the working capital needs were underestimated, as it was very difficult during 1994–95 to borrow money in Poland. The interest rate was around 43%. There was a need for further capital, which could be raised by the owners themselves. The role of Swedfund was very important at this stage. The participation of Swedfund had been highly appreciated by NE. The initial financial crisis could therefore be solved by the equity of the owners. Private people mainly owned the local shares, which comprised 45% of the total shareholding. A polytechnic institute owned 5% of the shares.

### **6.6.2. Resources**

The local people had sole production and technical responsibility. They could manage it quite well. The employees received on-the-job training in Poland by Swedish personnel and were shown how to run the production process and ensure quality control. The whole training was completed within a week. The machine was semi-automated. Twelve people worked on each shift compared to three in Sweden. When a new development took place in Sweden, documents and necessary materials were sent to Poland to be applied in the JV. There were, however, certain differences in the production process between Sweden and Poland. Only one product was manufactured in the JV whereas

four different products were produced in Sweden. NE was mainly responsible for technical support and financial contributions in the form of supplying the whole factory to the JV. NE did not pay any cash for the shareholding. Training and initial start-up costs had been included in the shares.

Used newspaper is the main raw material for the production process. Initially it was difficult to find these. The JV therefore engaged one of its local partner's firms to collect old newspapers in an organized form. This local company was also one of the major distributors of the JV product. The product of the JV won the best prize for 1997 in the construction industry. The marketing activity became very successful, as the product had been honored in different exhibitions. The manufacturing of plastic materials in the market was only undertaken by local competitors until 1998 when many other firms established their factories in Poland to produce rockwool and gulfiber, two substitutes for ecofiber products. The competitors seriously concentrated on the Polish market. The competition was very intense. The JV had a very small market share comprising around 2%. The JV has a target to reach a market share of 8–10% in the near future. A Polish company, which made a traditional plastic product, had the major market share in the country.

### ***6.6.3. Learning***

In the beginning, all important knowledge had been transferred from Sweden to Poland. In Sweden it was important that the product was environmentally friendly but this was not at all a demand in Poland. The local customers wanted, on the contrary, shining products. The marketing philosophy was, however, the same. The JV did not sell the fiber; rather it marketed a technical solution. The company wanted to provide safe houses and this implied a safe construction system. The local people had gradually come to accept this vital argument. NE offers guarantees against 'sick' houses in Sweden if the NE products insulate them. NE wanted to introduce the same strategy in Poland but Poland had not yet emphasized the environmental aspects of building houses. But competitors criticized the NE products in Poland as they did in Sweden. NE has experience of how to deal with such criticisms in Sweden. It now helps the JV to learn how to face its competitors in the Polish market.

The economic terms used in the discussions were difficult for the Polish partners to grasp; they had to learn simple financial terms. NE used the same marketing procedure in Poland as that practiced in Sweden. But it was difficult for the Poles to understand, especially the development and necessity of using sales channels. After this tedious learning process, the partners have learned

different financial terms and become familiar with marketing practices. The result of all the efforts started to become apparent in 1998, when the activity of the JV became a force to be reckoned with.

The Swedish partners, both NE and Swedfund, recently wanted to increase their shareholding position from 55% to 78% for easy decision making. The Swedish company learned that discussions took up valuable time before important decisions could be made. It is beneficial for the company that the decisions are taken promptly and efficiently.

#### ***6.6.4. Network***

The partners met at least four times a year after the establishment of the JV. The Swedish MD traveled to Poland together with a representative from SwedFund. One important contact was the distributor of the JV products. But this company was mainly engaged in other types of businesses. The Swedish partner considered that this firm would certainly be a potential candidate for developing business and collaboration if something had to be done in the future in Poland. If further expansion becomes necessary, NE may think to ask the distributor to join the company as a new but a more important local partner. The MD of the JV recently came into contact with a firm in the Ukraine interested in buying the company's product. The JV might sell to the Ukraine from the local production but nothing has been settled as yet. The Swedish MD was not sure about the economic situation in the Ukraine and was therefore worried about getting paid if the products were sold there.

The Polish professor, who was the main reason for establishing a JV in Poland, had been very helpful during the development phase of the firm. Afterwards, he became Education Minister in Poland and recently has been appointed as the Polish Ambassador in Sweden.

#### ***6.6.5. Performance***

The work in the factory and the overall performance of the JV was impressive. The local MD is a business graduate who runs the JV quite professionally. According to NE, the business in Poland was developing very satisfactorily. To continue with its steady growth, the NE management considered it necessary to invest further. The MD visited Poland several times in 1999 to discuss the possibility of opening a new factory in Warsaw under the same JV agreement. The purpose of establishing a factory in the capital was to establish new

important contacts with major customers. Another important reason was the risk involved in leaving an attractive segment of the market, which could prompt its competitors to invest. It was important for NE to maintain its current position in the Polish market compared to its foreign competitors. It was not, however, an easy task for the Swedish MD to make the local partners understand the situation. The current factory was running on two shifts and the product demand was on the continual increase. However, the local partners had a different view. They preferred to increase the production volume in the existing factory rather than establish a new factory. This was really a dilemma. The local partners were unwilling to invest further on the one hand and neither were they prepared to accept a decrease in the ownership position on the other. But this is very difficult for the local people to accept as they will lose their influence on the JV. The Swedish company wanted the local partners to trust them. The local partners were interested in short-term profits, but NE wanted a strong position in the market and more profits in the long-term. Unless the shares are sold, no profit can accrue to the local partners. The purpose of setting up a new factory was to increase the value of the company and its shares. Within a period of three years, the firm would be quoted on the stock exchange and the owners could expect a higher return. The new change in ownership was expected to come about within a short period.

#### ***6.6.6. General Environment***

Poland is a close neighbor of Sweden but the two countries' cultures are very different. There were cultural problems in almost every meeting of the board of directors. Recently, the Swedish partners have been considering a new factory near Warsaw. The local partners had difficulty in seeing people who could think of buying products from the new factory. NE argued that there were no buyers of the products in Poland before their entry to the Polish market. One had to create the demand as well as the market. One case of cultural difference was of particular interest. The JV in the beginning had a shortage of working capital. NE asked the local partners if it was possible to get payments from the buyers in advance. The local people said it was quite possible. After this assurance, the JV management decided to reduce the price for the buyers paying in advance. Consequently, sales went up due to the reduced price. The MD of NE was in Poland after three months but to his surprise he did not find any sign of advance payment made by customers. He made enquiries with the MD of the JV who became very angry at the Swedish partner. The Polish MD was sure that he was right because the JV succeeded in increasing its sales. One local partner, who

represented the technical school, had been in the USA several times, and he understood the problem. He took on responsibility for sorting out the problem. This local partner discussed with the other local partners for around 20 minutes and all present started shouting. The MD of NE then understood that he set everybody in a serious conflict. The MD of the NE gradually realized that they understood “advance payment” as “cash payment during delivery”. The concept of “advance payment” does not exist in the Polish culture. It was a misunderstanding and a problem of communication.

Another big problem was language. They did not understand each other. English was sometimes spoken by the partners, but did not function well. They used the same words but were not understood in the same way. There was a communication problem. In the board of directors meetings, all discussions had been translated into English and Polish. The Swedish MD demanded the appointment of an interpreter. A Polish woman has been appointed to help out in this respect. A major cultural difference exists between the partners due to the Communist background of the local people. They do not like getting straight to business issues. They talk about other things than the vital points. It is not appropriate in the local culture to talk directly about business. Now the situation is changing. The Swedish MD used to write down beforehand which questions should be discussed and decided. He used to explain things several times and even draw arrows and figures so that no misunderstanding could arise. Major changes have occurred in Poland in recent years. New technology is coming to the country and the local people are now prepared to change their previous mentality. The speed of modernization is rapid.

## **6.7. Korsnäs in Poland**

Korsnäs is one of Sweden's leading forestry companies, with its operations entirely based on renewable forest raw materials. Its production is principally concentrated on paperboard and paper products used in the packaging industry, fluff pulp for sanitary products, and sawn timber products for the joinery and carpentry industry. About 75% of final products are exported, reaching customers around the world. All basic manufacturing processes are concentrated in one place, the Korsnäs mill in Gävle. In 1998, the company employed 3,700 people of whom approximately 2,200 were engaged in Sweden. Turnover was around 5 billion Swedish Crowns in 1999.

Packaging is one of the divisions within the Korsnäs group. At Packaging, sack paper is processed to produce finished sacks and bags. These are used for packaging animal food, cement, sugar, flour, washing powder, etc. They also

provide complete packaging solutions, for example, systems for the handling of refuse, as well as protecting goods during transportation. Korsnäs Packaging Operation has factories in Sweden, Denmark, Germany, the U.K., Italy, Yugoslavia, Croatia and Poland. Korsnäs is to begin manufacturing sacks in the Ukraine and an agreement has already been reached. It will own 75% of the newly started company, which is expected to start production during the latter part of 2000. Its investments in recent years have been concentrated in Central and East Europe, a new important market for Korsnäs. Vigo Carlund, President and CEO of Korsnäs comments:

“We want to increase the competitiveness of Korsnäs Packaging in the established markets in Western Europe. We are concentrating our efforts both here and on our new markets in Eastern Europe.”

### ***6.7.1. Motives***

The Polish market was very attractive to Korsnäs: it had considerable potential due to the industrial development of the country. Poland was strategically important for the Swedish firm as it was geographically close to Sweden and suitable for investment given the country's favorable foreign investment policy. Another important motive for establishing a factory in Poland was that of increasing sales of products manufactured in Sweden. A further motive for Korsnäs to enter Poland was that of satisfying their existing customers as many of them were establishing themselves in Poland. But Korsnäs had no immediate plan to enter Poland alone and was therefore looking for a suitable partner in the country. Jefferson Smurfit (named Smurfit hereafter), an Irish multinational in the forestry industry, was also planning to establish a production facility in Poland almost at the same time. Both firms are competitors in many other markets. However, they came into contact with each other and seriously considered establishing a partnership rather than going it alone in Poland. This move was a test for the competitors on how they could share risk and control together. This was not seen as a major problem as the partners decided to limit their collaboration within the joint venture and not encroach on each other's sensitive business areas. Both firms trust each other regarding management, technical competence, knowledge, experience and so on.

### ***6.7.2. Establishment of the Joint Venture***

Smurfit is roughly ten times bigger than Korsnäs. The Irish company's main business is located in North and South America. Instead of competing in this

new and unsecured market, both companies decided to join forces and enter a partnership agreement. Thus, in autumn 1998, Korsnäs and the Smurfit Group established a joint venture with equal shareholdings. Neither of the companies demanded majority of ownership in the alliance. This entry mode enabled the companies to enter Poland and at the same time reduce the risks connected with this kind of investment. Korsnäs was the driving force in the discussions on the formation of the alliance. The reasons for this could be the experience Korsnäs had in establishing joint ventures in similar markets in Eastern Europe. Another reason was Korsnäs' unwillingness to enter Poland alone: it considered some kind of collaboration necessary. There were no other alternative partners when Korsnäs and Smurfit started the negotiation. This partnership was interesting in the sense that it was established between two Western firms in an East European country. The negotiation process to establish a joint venture took only four weeks.

The joint venture is located in Wierzbica, approximately 100 kilometers south of Warsaw, a poor working and farming area. Production started at the beginning of 1999 and the only products manufactured were industrial sacks. The company had 29 employees in the beginning who mainly came from peasant families resident within ten kilometers from the factory. Many of these employees were relatively young. There was a belief that younger people had different cultural values compared to the elder generation. The customers were major cement plants from all over Poland. Many of these were Western European companies and previous customers of Korsnäs and Smurfit who also established themselves in Poland. The Western customers had a major impact on Korsnäs when entering the Polish market.

### **6.7.3. Resources**

Korsnäs and Smurfit operate in the same industry: they produce and sell similar products. Both companies possess high technological know-how and have a well-extended network within the industry. The technology used in the factory is a globally used standard technology for the production of industrial sacks. A German half-automatic production line was bought exclusively for the joint venture. Technological know-how, production technology and finance were the major contributions by the partners. The exchange of experience helps the company to develop in the right direction in Poland, something that was considered very important by both partners.

The joint venture in Poland is a collaboration arrangement between two major actors in the paper industry, who possess a great deal of resources. The

technological know-how possessed by the two companies has been an important resource for the joint venture. It provides the company with access to new and competitive products and thus increases the potential for success. The partners also contribute raw materials. The quantity of raw materials each company can sell to the joint venture is regulated by the contracts. These contracts also contain other important agreements that regulate different obligations and rights the companies have towards the jointly-owned company. This measure reduces the chances of misunderstandings and also makes it easier to operate the company. The company employs 50 people who are Polish excluding the General Manager who is from Korsnäs. No Irish personnel are involved in the alliance but experts from both partners regularly visit the Polish operation providing technical and managerial support.

#### ***6.7.4. Learning***

Before the two companies entered this partnership some strategic differences could be noticed. Korsnäs usually establishes companies from scratch: it prefers green-field investments. Smurfit, on the other hand, usually acquires companies when expanding overseas. This is just one of the differences between these companies. Even though they produce similar products, their organizational routines, culture and management policies differ greatly. Korsnäs believes this creates an opportunity to learn from each other; mutual exchanges of knowledge, ideas, etc. are therefore considered natural in the relationship.

The collaboration between Korsnäs and Smurfit is relatively new, it is therefore difficult to say whether these two companies are learning something from each other. But given the knowledge and experience these two companies possess, it is probably the case that some kind of exchange of experience occurs between them. Learning is an ongoing process: the exchanges between these two companies will probably be enlarged to include factors such as market knowledge, market efficiency, production knowledge and technological issues.

#### ***6.7.5. Network***

Before entering the partnership, each party had its own network of customers and suppliers. In Poland, these networks are to some extent exposed. Korsnäs creates new contacts with the help of Smurfit. However, although the scope for developing new contacts only concerns Korsnäs, Smurfit is also in a good position to access Korsnäs's network. The partners' network in Poland may

include suppliers, suppliers' suppliers, customers, customers' customers, technical personnel and local contacts. But as the partners are competitors and have the same customers, it may be the case that they harm each other's interests by acquiring undue access. Korsnäs' network expansion is mainly concentrated around Smurfit and its own contacts in the region. As the joint venture mainly serves the Swedish firm's own customers, there is a risk that the customers are introduced to Smurfit's personnel who can further develop the relationships for future collaboration. When the alliance was formed, Korsnäs thought about this risk but the perceived total advantages outweighed this shortcoming.

#### ***6.7.6. Performance***

The joint venture in Poland has had a successful first year, products were sold out and new investments were needed to increase production capacity. The two foreign partners were satisfied with the results accomplished by their joint owned company in Poland. Both Korsnäs and Smurfit are said to meet each other's requirements and the joint venture's expectations so far. The turnover of the alliance was 75 million Swedish Crowns in 1999. No major problems regarding the collaboration have been detected since the start. One of the reasons for this is that the joint venture is relatively new and operating quite well. The two companies have recently agreed to establish a further alliance to market and sell paper sacks for the collection of compost household and garden waste. According to the understanding, the new operation will be located in the Netherlands with sales offices initially in France and the U.K. Korsnäs and Smurfit believe that strategic cooperation of this kind in specific areas will complement their respective businesses in the paper sack sector. It is, however, difficult to measure the intangible returns of the collaboration arrangement such as technical and cultural adaptation, trust, learning, etc. These outcomes will probably be measured in the near future, but it is too early to say if these outcomes will be negative or positive. Korsnäs does not think that the larger size of the other collaborating firm has been a problem.

#### ***6.7.7. General Environment***

Poland was one of the first countries from the former Eastern bloc to transform its political system. It moved toward a more open economy relatively early compared to other countries within the bloc. These changes have increased the incentive for foreign companies to invest in Poland, and these investments have

had a positive effect on the development of the country. During the establishment of the joint venture between Korsnäs and Smurfit, the local authority was helpful on judicial and formal aspects. The government was favorable toward the establishment of a joint venture. Yet even though Poland is changing its political and economic system, old socio-cultural forces still have an impact on people's values. These differences are important to understand, as Korsnäs and Smurfit have tried to overcome this cultural problem by hiring younger people who are believed to have different values and a more similar lifestyle to those in the West.

## **6.8. Vattenfall in Poland**

Vattenfall is one of the largest energy companies in the Nordic region, accounting for 20% of total electricity sales. The Group generates its electricity primarily through hydro and nuclear plants, with supplementary production using other energy sources. Vattenfall also conducts operations in the areas of heating and natural gas, as well as services and consulting for the energy sector. Vattenfall has directly or indirectly 2 million customers. Its customers are energy companies and other industrial enterprises in the Nordic region, as well as retail customers in Sweden and Finland. Vattenfall is also active in Germany, the Baltic countries, Poland, Austria, Holland, the Czech Republic, Southeast Asia and South America.

Vattenfall is a state-owned company. Half the atomic power plants in Sweden are owned by Vattenfall. It had 33,900 employees in 2002. Net sales of the company went up to 69 billion Swedish Crowns in 2001. Vattenfall's monopoly in the Swedish market ended with the deregulation of 1996. At this time, Vattenfall started planning to expand its business in other countries, as many countries in Europe had either deregulated or were on the way to deregulate their energy market. The Swedish firm has the ambition to become a leading supplier of energy in Europe. To reach this goal, Vattenfall is concentrating firstly on the neighboring countries around the Baltic region. Geographical proximity is an important factor in the internationalization strategy of Swedish firms. Vattenfall now has establishments in about 10 countries in Europe including the Baltic states, Germany, Norway, Finland, the Czech Republic and Poland.

### ***6.8.1. Collaboration in Poland***

Vattenfall had been active in Poland since 1992. At first it had a representative office, and since 1995 its representation has consisted of a limited liability

company. Vattenfall Poland Sp. was the first foreign company to be granted a licence for electricity trading throughout Poland. Its main functions were to observe the market and to get ideas about Polish laws and regulations, especially those concerning foreign firms' operating scope in the country. Polish deregulation in the field of energy and power was enacted in 1998. The wholly-owned company had 20 employees at the beginning of 2000. Most employees are engineers; two of these are Swedes including the MD. The company is now responsible for developing Vattenfall's business in Poland.

Besides the wholly-owned company, Vattenfall is involved in three joint ventures and a few collaboration arrangements in Poland. Its aim has mainly been to function as an investor in the energy field as well as to contribute its knowledge and competence to ensure efficiency in production and marketing of its products through its affiliated companies. Vattenfall entered in the first joint venture (Ostrowski Energy Utility) in 1998 to supply heating in the southern part of Poland. Vattenfall owns 23% of the shares in the company. The installed capacity of the plant is 100MWth. In the second joint venture, Ustka Energy Utility, Vattenfall owns 34% of the shares with an installed capacity of approximately 35MWth. The equity ownership was bought by Vattenfall in 1999, also to supply heating in some other parts of Poland. Vattenfall acquired a majority holding from the Polish government to enter into the third joint venture. The agreement was signed in January 2000 and Vattenfall had to pay approximately 2.2 billion Swedish Crowns to buy the shares. The agreement also provided Vattenfall with the opportunity to purchase additional shares. Based on a bidding procedure, the Polish government decided to conclude an agreement with Vattenfall. This was one of the biggest business deals in the Polish privatization process.

Vattenfall was chosen as the technical advisor for the start-up of a combined heat and power plant at Kostrzyn Paper's facility in Gdansk. Cooperation between Kostrzyn Paper and Vattenfall started in 1999. Initially, Vattenfall rendered advisory services in the field of heat and power plant management, which resulted in a significant increase in the efficiency of the plant. The contract for advisory services has been prolonged for 2001. Thanks to fruitful cooperation between Vattenfall and Kostrzyn Paper, Vattenfall was chosen by the strategic investor WZP in Poland to be the advisor for the modernization of WZP's heat and power plant. Vattenfall was responsible for the technical and organizational restructuring of the plant. It was also involved in a project to create a high voltage link between Poland and Sweden. Vattenfall and the Polish partner worked to construct the link between two cities — one in Poland, the other in Sweden. The project comprised the construction of two AC/DC converter stations together with the laying of a 240km cable under the seabed.

The value of the project was estimated at 3.3 billion Swedish Crowns. The system would improve the reliability of the supply systems of Poland and Sweden and have a positive impact on economic developments and environmental protection in both countries. The start-up of the link was expected in 2000.

### ***6.8.2. Recent Collaboration***

Vattenfall acquired a majority holding in the Polish energy company, Electrocieplownie Warszawskie SA (EW) from the Polish government. The agreement was signed on 27th January 2002. The purchase price was U.S.\$ 235 million. The agreement provides Vattenfall with the opportunity of purchasing additional shares. Based on a bidding procedure, the Polish Government decided to conclude an agreement with Vattenfall. According to Jörgen Andersson, Vattenfall's appointed Chairman, EW strengthened the Vattenfall presence in the Baltic Sea region. EW is a well-managed company with qualified employees, and the standard of the company's plants is high. The company conforms to all the Polish environmental legislation in force today. However, future investment must be made in order to meet the tighter demands of the European Union. EW now accounts for around 98% of the district heating production and around 68% of the electricity used in Warsaw.

### ***6.8.3. Resources***

The raw material used in EW's operations is coal and is collected through local sources. About 120 people are employed in the company. In all the companies, Vattenfall has representation on the board of directors and is not directly involved in production or day-to-day activities. But there is a plan to successively become involved in operations and helping the companies with its experience and knowledge in improving efficiency. The local shares are owned by the Polish government. The local board members are government officials who do not generally have any practical knowledge about the field. The policy of Vattenfall is to wait and see how things develop and gradually develop a good understanding with the local people before proposing any changes. The technology used in the operations is, however, quite advanced.

### ***6.8.4. Learning***

Vattenfall's early presence has helped it learn the business practice and local laws of the country. The Swedish company considers the development of local

networks is very important in Poland especially if a company is involved with government partners and also sells to the government authorities. As it was present in Poland some years previously, it had been helpful for Vattenfall to come in contact with different important policy making institutions and major customers.

#### ***6.8.5. General Environment***

There are some basic differences between Sweden and Poland in doing business. Poland had been a Communist country for many years and, therefore, there were still many things to change. The administrative system is being reformed. The state bureaucracy is still in place. Many new laws have been undertaken after the political changes but many of them had not yet been tested in the courts. The country has the declared ambition of having a market economy and has already succeeded in attracting many foreign companies to invest in the country. Given the extent of the changes, it is a young nation. People are ambitious, and many work for more than eight hours a day. In daytime, people go to their jobs and in the evening they attend schools to study. Polish society is very dynamic. There has been steady economic growth in the country: the growth rate in the last few years has been around 5–6%.

Poland, which has 39 million inhabitants, is now in an expansive phase of its development and its electricity demand is set to rise. Warsaw in particular is in the course of a very robust economic development. Due to its strategic geographical location, Poland is an important stepping-stone for both promoting cooperation with local customers and aiding Vattenfall's expansion in the remainder of Europe. Its strategy for Poland is based on the development of activities in three main areas: electricity trading, distribution, and the generation of electricity and heat. The electricity market in Poland has not fully opened yet. During 1999, only customers with annual purchases of electricity greater than 100GWh were allowed to choose their supplier. In 2000, the limit was reduced to 40GWh. Currently Vattenfall is carrying out pioneering work aimed at signing the contracts for the supply of electricity with customers.

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## Chapter 7

# Alliances in the Medium-Adapting Countries

## 7.1. Kallefall in Lithuania

Kallefall is a small-sized firm that started to operate in Tidaholm, in 1993. The main products made by the company are tractor-drawn tree-cutting machines, and its main customers are small farmers and the forestry industry. Over the last three years, Kallefall doubled its sales volume from 10 to 20 million Swedish Crowns. Also in the last few years, Kallefall has developed several collaborations with local companies in Lithuania, the most important local partners being Neris, Utenos and Mekanika. This case focuses on Kallefall's cooperation with Neris.

### *7.1.1. Motives and Initiation of the Alliance*

It was Kallefall that took the initiative to enter Lithuania after a few years' operation in Estonia. The Estonian partner was not doing well and the cost of production was increasing at a higher rate there. Production costs were found to be lower in Lithuania and the local market was also more attractive than the Estonian one. Further, the Lithuanian partner was believed to be an efficient counterpart.

Negotiations between Kallefall and the Lithuanian partner, Neris, were not yet complete. The partners have recently reached an agreement and signed a contract, though some minor changes, e.g. to prices, volumes, guarantees, and other details, may take place in the future. There were differing opinions regarding the guarantee. Kallefall offers its customers a 1-year guarantee that the product will meet the declared functions. However, the local partner Neris is hesitant to offer any guarantee for its products because the concept of "guarantee" is not yet understood in Lithuania. The main purpose of forming the cooperation on the part of Kallefall was to produce a good product at a

competitive price. The aim of Neris in forming the alliance was mainly economic, i.e. to increase income, to strengthen financial capacity and to secure survival in the market. Neris' operative volume was very limited and it had, as a result, a weak financial position.

Realizing this, Kallefall tries to help its partner in several ways from a financial standpoint. In the case of credit sales, Neris gets an extra 30 days of credit over and above the 90 days given to other Kallefall customers. Neris can also get a partial payment in advance for the materials Kallefall buys from Neris.

### ***7.1.2. Resources***

Kallefall supervises local production, mainly to identify technical problems or whether there are other requirements necessary for smooth operation. Kallefall provides the necessary help, for the most part to their factories. In addition, it helps Neris understand the requirements for supplying products to the West, particularly in terms of quality and finishing issues. The quality must be good and up to standard. Moreover, the finished product must look good and be attractive to the buyers. To meet quality and appearance demands, Kallefall specifies a list of requirements which Neris must fulfill.

The local partner is responsible for the purchase of raw materials on the basis of Kallefall's needs. Kallefall clearly states the required quality of the material in its drawings and Neris accordingly buys the material and carries out production on the basis of the given specifications.

Moreover, Kallefall helps Neris with manpower and skills' development especially for technicians and production staff. This development of skills focuses on welders and other experts in the field. Kallefall sends welding experts to Lithuania to upgrade their knowledge and skills so that the required quality level can be achieved. The experts show the local people how to do the welding properly in practice. Kallefall offers Neris' employees ideas in all possible areas, with the aim of getting them to understand how customers in the West think and act. Kallefall also provides computer training and office management courses to the local people to upgrade their communicating skills. Kallefall is also responsible for financing, although Neris also contributes part of the financial resources.

### ***7.1.3. Learning***

Both parties have been learning from the collaboration. Kallefall has learned that it must have patience; in comparison to the West, it takes a long time to

carry out projects in Lithuania. Neris has learned that developing products for the West is a very demanding and challenging task. There are high demands on quality and finishing that must be combined with a guarantee. The seller has to be able to ship the products according to the supply schedule and other related programs. In sum, Neris has learned that they have to work hard to ensure on-time supply. The cooperation has also resulted in mutual learning. Changes and improvements have occurred in several small areas, e.g. quality, finishing, secure supply and guarantee.

#### ***7.1.4. Network***

The cooperation with Neris has enabled Kallefall to develop new contacts in Lithuania. It buys most of its components locally, and there are several new factories that now supply Kallefall with the components used in its production in Sweden. Neris has helped Kallefall to develop many such contacts with the suppliers, and also sees that the relationships function properly. The networks developed are very helpful for Kallefall, because things have become more competitive since establishment of the joint venture. Since it began collaborating with the Lithuanian partner, Kallefall has been getting better products at a lower price than most of its competitors.

#### ***7.1.5. Performance***

The results of the alliance thus far, have fulfilled Kallefall's expectations. As expected, Kallefall is getting better quality products with a good physical appearance. It also hopes that the situation will become even better considering the increasing demand and the nature of the cooperation. As Kallefall is doing well with the local partner, it continues to collaborate. Neris is also satisfied with the cooperation. It did not complain about the results achieved, and showed a readiness to continue the cooperation. Neris has proved to be capable of supplying Kallefall competitively priced, improved quality products with a better appearance. This good performance by the local partner increased its importance for and closeness to Kallefall. Because the partners have been satisfied, they have developed the collaboration further. As Kallefall wants to set up a factory there to run in Western management style, they have agreed to establish a jointly-owned company in Lithuania. Kallefall will own 46.5% of the company, Neris 30%, and a third party will get 23.5% of the shares.

### **7.1.6. General Environment**

The general environment in Lithuania is somewhat different and therefore functions differently than we see in the West. Traditionally, there has been much paperwork in Lithuania, with everything that is going to be done put on paper. A vast amount of groundwork must be done before any business activity is carried out in the country. Further, the speed at which things are done is also very slow in Lithuania. The concepts of product quality and appearance are not the same as in the West. In general, demand on quality, finishing and producer responsibility are very low, a trait inherited from the old Russian system. This low level of responsibility still exists in the minds of the people and their way of doing business. This is something that will most certainly take a long time to change. In the old Soviet period, if an employee made a mistake he would be immediately fired or imprisoned in Siberia. Thus, if unsure, it was always better to do nothing at all. Such a system and its impact on the minds of its citizens yields very slow work and the chances of developing one's skills are minimal.

Today, the level of technical development in the country is good, except in the field of welding. In order to upgrade their welding capacity, Kallefall sends welders and a number of other experts from Sweden, who are able to transfer and upgrade the skills of Neris workers. This is one way of helping them to build and develop their capabilities. There is a big problem in Lithuania due to the shortage of capital. Neris' financial situation is poor and this affects the cooperation. The number of employees in the workshops is very high and they must wait several months to get their salaries. This has a negative impact in the cooperation and results in delivery delays, because if people are not paid their salaries they can not work at all or they can not perform properly.

## **7.2. Arvidsson Textile Share Company in Estonia**

Arvidsson Textile Share Company (hereafter Arvidsson), was established in 1949 and has since been operating in western Sweden. Up until 1995, it produced household textiles, but over the last 4–5 years, it has begun to produce furniture as well. These new products are produced in Estonia. The company's total sales for 1998 totaled 80 million Swedish Crowns, and projected sales for 1999 were expected to be 90 million. Although it lost market shares in household textiles in 1999, it is expecting an increase of about 12% in sales volume. The company employs a total of 64 in Sweden and about 40

in Estonia where the cooperation is taking place. Arvidsson is owned by the Arvidsson-Carlsson families. The two families own 50% each of the total shares in the company.

Arvidsson has established a strategic alliance in Estonia with a local partner by the name of Nikkinen Mentu Aktieselts (N&MAS). The company in Estonia is owned by two partners who own 45% each, and a third who owns 10% of the shares. The main activity of the company is producing household for Arvidsson.

### ***7.2.1. Motives and Initiation of the Alliance***

To begin with, Arvidsson textiles was looking for a partner in Poland. Several discussions were conducted, but Arvidsson could not arrive at a good solution. Later, it turned its sights to Estonia spawned by a number of old relationships with Finnish contacts. These people had already established a company in Estonia and operations were going well. Arvidsson contacted the Estonian company and asked them whether they would be interested in forming an alliance together. The Estonians accepted the offer and that is how the alliance was established. Arvidsson specifically chose this local partner, because it had a Western background and could also speak the Estonian language. At the same time, finding a company already operating in Estonia was very advantageous for Arvidsson.

Arvidsson entered Estonia for two reasons:

- (1) production costs in the country are low; and
- (2) geographically, it is very close to Sweden, making it easier to get there.

Arvidsson, who took the initiative for the cooperation, had been experiencing tough price competition in the home market. Producing goods in Sweden was extremely expensive, rendering products uncompetitive. The cost of production for one particular product in Sweden was 80 Swedish Crowns whereas the same product could be produced in Estonia for only 20 Swedish Crowns, a net savings of 60 Swedish Crowns per finished product.

The main purpose of Arvidsson forming the alliance was to offer competitive pricing and thereby sell more of its product at a higher margin. During the early 1980s, the company had a high production and a high turnover. But at the end of the 1980s and early 1990s, the Swedish economy went through a difficult period and business owners felt a strong need to produce goods in a low cost country to drastically bring down the cost of production. In line with this

strategic decision, Arvidsson entered into the collaboration and moved a major portion of its production process from Sweden to Estonia.

### **7.2.2. Resources**

Arvidsson started operations on a small scale and gradually became larger and larger. To begin with, it moved parts of the production process related to new products to Estonia. As it was not possible, for practical reasons, to move everything to Estonia, a large portion of the manufacturing of older products was left in Sweden. The company had so many big automatic machines in Sweden that the freight alone would cost a huge amount of money. In the 1960s, Arvidsson had had large operations in Portugal, as it was a low cost country at that time. Many companies moved their production from Portugal to Hungary, later from Hungary to Poland, and most recently from there to the Baltic States. There are also several firms who moved their operations to Russia for cost reasons. In Arvidsson's case, operations were moved directly from Portugal to the Baltic States. In sum, what Arvidsson expected from the collaboration was to lower production costs; the Estonian partner wanted to make a good income. Other aims of the local Estonian partner (N&MAS) were to own a building, land, and to start local production, i.e. to expand its field of operations and produce more through the collaboration.

Arvidsson is responsible for purchasing and for sending material to Estonia. The Estonian partner carries out the production and sends the finished products back to Arvidsson in Sweden. Arvidsson has also lent several machines to the local Estonian partner which it uses in production. Further, Arvidsson trains and educates the employees of the local partner to upgrade their technical know-how, which they use in production. Arvidsson finances the Swedish part of the cooperation, and the local partner finances the Estonian part. Arvidsson sends people to Estonia for 2–10 days at a time to contribute whatever knowledge and capacity the local partner may need, especially in production. The local partner is completely in charge of production and employing workers locally, as there is ample manpower. The Swedish firm is responsible for marketing and product development.

Another important contribution of Arvidsson is skills development. With the financial aid it receives from SIDA, it provides training and education for the local manpower, to further develop their competence. The skills development project is carried out in several phases, and is extended to everyone employed in the company. It costs a lot of money to develop the program, and to educate and train the employees. It is also a time-consuming process but helps

Arvidsson to develop and change the Estonian partner's way of thinking and performing their duty. Although, the upgrading program is being financed by SIDA, the company would have financed the program by itself in the absence of this assistance. In this sense, the support from SIDA is greatly appreciated by the Swedish partner.

### ***7.2.3. Learning***

It happened quite often that goods delivered to the customers of the joint venture were defective. In such instances, the customers became dissatisfied, especially if there was no time to correct the mistake. This fault had to be rectified, and on such occasions, the foreign partner became involved. The problem of defective goods could be critical if lead times were short. There was an absence of overall planning in this area. Arvidsson had to inform the customers that supply could be delayed. This close collaboration helped the partners to work better together and season by season, they learned how to improve things. The partners also learned that things did not happen or change overnight. The local partner learned two things from this: the importance of planning, and the need for close collaboration with Arvidsson.

The local employees also learned a lot through the training and skills' development program. Most of the teaching and training involves cutting the textiles into the proper sizes and sewing technique. They are also taught how to upgrade their own technical know-how which is needed in the factory. N&MAS manages production, and Arvidsson transfers the necessary knowledge throughout, so that the local partner's knowledge of the operation is satisfactory. Arvidsson has also learned how the local environment functions and has gained enough experience of a number of problems that can arise in government and various authority relationships to be able to handle them.

### ***7.2.4. Network***

Arvidsson has developed new contacts, particularly with suppliers, in connection with its operation in Estonia. As Arvidsson is operating in a highly competitive market, development of an appropriate network is a prerequisite if the company is to build a strong position in the market. It developed contacts in Estonia with the help of the local partner, to ensure quality and supply so that the alliance operation can function smoothly.

### **7.2.5. Performance**

Arvidsson serves customers in Sweden, Norway and Finland at competitive prices, which was also one of its main aims in establishing the alliance. The alliance has thus fulfilled Arvidsson's main expectation. The foreign partner claims that the alliance has been functioning very well although there have always been some operational problems. The advantages of the collaboration were many for Arvidsson. For example, it could get the products at a competitive price without compromising with quality. Direct supervision of the alliance by Arvidsson gave the partners an opportunity to work closely together. The Swedish firm has been satisfied with the alliance performance and believes that the situation will be better in the future. The local partner has also achieved its objectives through the alliance. One of its aims was to own a building, land, and start production in Estonia. It now owns the land and has the opportunity to construct its own factory building. Its other motives of increasing production and quick growth have now largely been achieved, though many improvements are still possible.

Both Arvidsson and the local partner intend to continue the collaboration. The Swedish partner is now in a position to buy products from other local suppliers if market demand is very high. The production capacity of the local partner is not yet sufficient to meet all of the demands. Through the collaboration, Arvidsson enjoys credibility with the local producers in Lithuania. There is always development potential, both with respect to increasing market share and increasing local supply of products, though not necessarily through the alliance's own production.

The other important result of the cooperation is that the local partner and its employees have largely adopted the Swedish way of thinking. A good example is that one can now directly call and ask anybody in the alliance and get an immediate reply. Before, it was only the boss who could reply, and the others were not authorized to respond or act. It has become faster and easier to communicate and get a response, which shows that the cooperation is working properly. As a result of the training and skills development, there are now people in the organization who can take responsibility and reply to most inquiries that come from the Swedish partner.

### **7.2.6. General Environment**

Several times misunderstandings arose due to language problems between the collaborating partners. Another problem was differences in the way of thinking

and working. Estonia was under Russian administration for many years. It will therefore take a long time to change the way of thinking and working, especially for older workers. Those who were under the age of 20 at the time of liberation, have a more modern way of thinking than those who lived longer under the Soviet system. The latter group continues to live by the older system and has difficulty accepting change. The concept of “planning” did not exist at all, whereas in the West, people work with the long-range planning all the time. In order to know what will happen next week, next month or next year, Western businesses draw up 6-week plans, 1-year plans, etc. Beyond that, preliminary 2-year plans and 5-year forecasts are common and used by many, if not all, companies. In countries like Estonia, there is no such approach or planning culture, which creates an obstacle for the efficiency and proper functioning of the alliance.

Another aspect that has helped to smoothen the way for the cooperation is the financial assistance Arvidsson received from SIDA. This financial aid helped to develop the skills of the local manpower. The program, developed and implemented by the foreign partner, made the alliance more effective and efficient. Although the possibility of borrowing money from banks in Estonia does exist, the interest rate is very high, at 16–18%. This makes it expensive, limiting the ability of both parties for expansion through credit financing.

### **7.3. DPC Skaffe Share Company in Lithuania**

DPC Skaffe Share Company (hereafter Skaffe) is a Swedish subsidiary of an American firm, Diagnostic Products Corporation. The American firm specializes in research, production and sales in the area of diagnostics. Skaffe had been operating in the same field in Sweden since 1970 and in the Baltic States since 1994. In 1998, Skaffe’s sales volume in the Swedish market was 35 million Swedish Crowns, and about 10 million Swedish Crowns in the Baltic States. For 1999, the company projected an increase in sales of about 10–12% in the Swedish market and an increase of 20% in the Baltic States. Skaffe sells diagnostic instruments to diagnose cancer, hormones, allergy and other disorders to the balance in the human body. The company is 100% self-financed and is among the 2700 highest valued companies in Sweden. Skaffe is certified by AAA, a big accounting and financing company that reviews the financial statements of all Swedish companies before certification. To receive AAA certification, a firm just demonstrates a solid financial position.

### **7.3.1. Motives and Initiation for Establishing the Alliance**

Skaffe is operating through a strategic alliance with a local partner by the name of Diagnosta in Lithuania. Skaffe preferred to have a local partner in Lithuania to develop and manage the necessary political, governmental, and ministerial contacts. The local partner has contacts with various ministries and influential people working in these ministries. It deals primarily with the Ministry of Health and maintains contacts with various decision makers at different levels. The Ministry of Health and many other government organizations are old customers of the local partner who maintain very good relations with them. These authorities either buy Skaffe's products directly or play an important role in granting the necessary financing to other potential buyers of Skaffe products.

Both Skaffe and Diagnosta worked in different forms in the Lithuanian market before the alliance. Key people from the two companies met in different business contexts, held a number of discussions, which finally led to a collaboration agreement. The local partner is a well-known company with a very good reputation. It is a bit difficult to say which partner took the initiative to the collaboration. Rather, the initiative was mutual as both partners met and showed an interest in collaborating.

Skaffe had a fully-owned company before the collaboration, but operating its own company in Lithuania turned out to be very difficult. A big organization was needed in order to have wide market coverage. As Skaffe did not have a big organization, collaboration with a well-reputed local company was a good solution for the company. Diagnosta was interested in Skaffe's equipment, i.e. getting modern techniques into the market, and, at the same time, Skaffe was looking for someone with good relationships with the right actors in Lithuania in order to enter the market. The local partner was also expected to represent Skaffe in a proper manner in the Lithuanian market. Skaffe was expected to provide a package of quality products, which would be easier to sell and to gain quick market acceptance. Besides its commercial aims, Skaffe was also willing to help the local partner by providing several medical appliances free of charge.

### **7.3.2. Resources**

Diagnosta contributed with the market, i.e. customer contacts, services and sales. It also had the responsibility for legal matters, policy issues, registration formalities and contacts with local authorities. Skaffe helped the local partner develop the necessary knowledge on how to use modern scientific technology.

It trains and educates the local doctors so that they can use modern immunological methods in diagnostics. Skaffe trains both the local partner's personnel and its customers, i.e. the end users of the medical equipment in their applications. The foreign partner installs the products, demonstrates how they work, and also provides the necessary servicing. To be able to use Skaffe instruments, the local partner has to understand and interpret the results generated by the instruments. To this end, Skaffe sends doctors who are specialists in this area to Lithuania. The foreign specialists hold seminars and lectures for the local doctors. Lectures focus on what products Skaffe produces, the type of results one can get by applying these products, and how the results can be read and interpreted.

Moreover, the lectures cover how the doctors can utilize the products in order to improve medical service for their patients, which, in the end, is more cost-effective. The concept is that hospital stays get shorter, and patients receive better services and the right medical treatment. Skaffe's product is not a simple one, but a package that includes the product, knowledge and application skills necessary to manage the product. Skaffe is also responsible for purchasing. Together with the instruments, it must buy the reagents consumed in operating the instruments. That is, operation of the instruments requires a continuous supply of the material reagent and immunological reagents.

Diagnosta, the local partner, manages the necessary manpower, but Skaffe is responsible for upgrading the knowledge and skills of this manpower, which consists mainly of doctors and technicians. Although there are many doctors in Lithuania, it is difficult to find good technicians. To upgrade the local partner's technical skills, Skaffe sends personnel to Lithuania to train them. It also sends some Lithuanian employees to DPC's factories in the USA. Skaffe's personnel conduct courses in medicine, various applications in cancer diagnostics, allergy, fertilization, etc., in Lithuania. It invests a lot to bring about transfer of the necessary knowledge to Diagnosta and its customers.

One of the most important and essential contributions of Diagnosta is its expertise in managing the domestic market and contacts with the influential people in Lithuania. Diagnosta is a well-known company and has a good knowledge of customer preferences and attitudes, good company control of the home market, and knows how to manage and deal with the economic situation. It is able to enter the agreements and contracts needed in a proper manner and in a short period of time. Diagnosta is very competent in its fields of operation. It would have been much more difficult for Skaffe to sell directly in Lithuania. It is not easy to do business and to control the situation in a foreign country where a physical presence with local contacts is a necessity.

### **7.3.3. Learning**

Skaffe claims that it has learned how to deal with export to the Baltic States, and has learned much about communicating and working with people of this region. The local partner Diagnosta, on its part, has learned how to get access and apply modern technique in the hospitals, how to provide better medical service, and how to effect better diagnosis of diseases. It has also learned how the new medical analytical method functions and how it can be used in medical care. The local partner has acquired all this knowledge and expertise through the education and training, and the skills development programs Skaffe has conducted in Lithuania. Both partners have benefited from the various types of knowledge as they complement each other in a broader perspective.

### **7.3.4. Network**

Diagnosta has successfully created a contact network for the alliance, and Skaffe visits all of its key customers in the local market once or twice every quarter. The local partner has introduced Skaffe to its customers. Consequently, Skaffe has gained fruitful contacts with the hospitals, big universities, and leading hospital and development laboratories. Skaffe uses its techniques and applications in all of these customers' premises. It had contacts with the laboratories even before it started to collaborate with Diagnosta, and had long maintained contacts with customers in the Baltic States. It organized exhibitions, which were attended by several people from Lithuania and the other Baltic States. These contacts have also developed in several ways. Skaffe's products are distributed through the laboratories to universities, clinics, and hospitals. The local partner has made a substantial contribution to establishing contact with a number of important laboratories. Even the clinics send their patient tests to these laboratories and receive result and replies through the same channel. This demonstrates the strong collaboration among hospitals, clinics and laboratory personnel.

With the help of Diagnosta, Skaffe has also developed relationships with various government authorities. The granting of funds and major decision making are done at these levels. Contact with the heads of individual laboratories is not enough. Contacts must be made at a higher level in order to sell in Lithuania. Hospitals, laboratories and universities are not able to make purchasing decisions independently. They are totally dependent on the political support required for allocation of funding. That is, a hospital does not have the financial strength to make its own decisions. It is the authorities who control its

operations through grants. Regarding the local partner's network with the foreign actors, however, Skaffe has not done very much in extending this network.

### ***7.3.5. Performance***

Both parties are satisfied with the results achieved so far and have declared this openly on various occasions. Skaffe wants to continue the collaboration as it is working well and generating a good income. If the opportunity should arise, Skaffe is willing to cooperate in other areas with Diagnosta. The local partner, on the other hand, is very much goal-oriented and is only interested in working with and selling the products that are currently supplied by Skaffe. Diagnosta's market share for Skaffe products is gradually increasing and the relationships with the customers are sound.

One of the expectations Diagnosta had for the cooperation was that the new medical equipment from Skaffe would help to shorten hospital stays, and provide patients with better medical service and the treatment they required. Although this has been a lengthy process, both parties have succeeded in moving forward toward their goals. To this end, Skaffe will continue to send its experts to Lithuania to support and upgrade the skills of local doctors and employees of the local partner.

### ***7.3.6. General Environment***

As development has not reached the same level as in the West, there is a shortage of financing in Lithuania. The level of technological advancement is also low and there is a shortage of technical skills. Although Lithuanians have a very good theoretical knowledge, they lack the corresponding practical expertise. When it began operations in the country, Skaffe faced a shortage of telephone and fax systems. This made it very difficult to send messages and contact people. Recent improvements in this area and Skaffe sending computers to Lithuania has led to all of its systems now being equipped with computers.

The cultural gap between Diagnosta and Skaffe is very wide. Diagnosta does not have the experience of managing a company in the way Skaffe does. For example, Skaffe makes an overall plan that includes cost calculations, competitive pricing as well as the product and service offerings that customers want. Until the political change came, people in Lithuania never had the freedom to act on their own. The local market has limited resources to buy

good products but the people are very ambitious. The environment is very dynamic and there is an acute shortage of money. One must therefore find other financial solutions in order to capacitate the local customers to buy costly equipment. One must sign a long-time contract to receive payment, i.e. offer a comparatively lower rate of interest and also allow payment in a larger number of installments.

The local partner does not share the same ethical views. It is complicated to import goods to Lithuania. The administrative work is difficult and time-consuming. One must meet Lithuanian documentation requirements and register everything with the proper authorities. There are also documentation requirements in Sweden, but they are completely different from those in Lithuania, and in the EU, the documentation has been made very simple. In Lithuania, every product must be documented with comprehensive paperwork that must be translated into Lithuanian. All this work results in enormous costs. Each and every change made must also be documented and paid for.

The rules and regulations governing these processes are also completely different from those in Sweden. The country does not have a properly developed legal system. Skaffe employs local jurists to enable adaptation of its operations to the Lithuanian legal system. In so doing, it shows flexibility, because when entering foreign countries one can not expect to transfer the Swedish legal system but must comply with the local legal system. However, the company does attempt to remain as Swedish as possible, while adapting itself where necessary to the new environment. An attempt is now being made by the government in Lithuania to change the country's legal system to adapt it to EU regulations. The partners' different experiences, backgrounds, and languages affected the cooperation. The differences influenced their understanding, and many things were interpreted in completely different ways than they were intended.

## **7.4. Partec Rockwool in Lithuania**

Partec Rockwool (hereafter Partec) is engaged in the production and marketing of insulation materials. There are three types of insulation materials, i.e. mineral wool, plastic wool and cellulose wool. Mineral wool contains two main groups, i.e. glass wool and rock wool (stone wool). Partec works mainly with stone wool and recently expanded sales and manufacturing of this product to the Baltic States and Poland. The total turnover of the firm in 1999 was 2.5 billion Swedish Crowns with a total of about 1500 employees working in the different parts of the world. In 1999, Partec sold a majority of shares to the

Industry Capital Investment Company (ICIC) in Stockholm. ICIC holds roughly 55% of the shares and the Partec group owns 40%.

Formation of a joint venture as the first step of establishment in Lithuania and Poland has been a part of Partec's 'Baltic Rim Strategy'. The reason Partec chose to focus on the former Comecon countries is because it saw a possibility of capturing a major position in the insulation markets of these two countries. When the Soviet Union collapsed, a totally new business opportunity was created for Partec Rockwool. During that period, Western Europe was a well-structured and fairly saturated market that offered a limited scope for expansion and growth potential. The former Eastern Block offered completely new opportunities with markets where there was a huge demand for Partec Rockwool products. In 1992, Partec Rockwool established sales offices in the three Baltic States in order to build up a marketing organization with a solid customer base so that local production could be started at a later stage. This move cost the company 150–200 million Swedish Crowns, which was a very large amount at that time. This investment was made at a time when the region was considered to be complex, extremely risky and uncertain for foreign investors. Cultural differences, which among other things were characterized by 50 years of socialist administration and deeply rooted bureaucracy, exacerbated the problem further. There were no valid regular procedures or decision-making norms and policies in the region. Due to these and other relevant factors, Partec decided to establish a JV with a local partner with a good understanding of how this region functions. A partner who could deal appropriately with the problems and constraints of day-to-day operations was needed. The local partner was also expected to identify potential customers, and to have commercial interests and the capacity to distribute the construction materials produced by Partec. This model worked well in Lithuania. Partec worked for two years with the local partners through those sales companies. After two years of operations, the company achieved the expected purpose, i.e. it established a core of employees that came from the local market and had a good understanding of how the environment and market functioned. At that stage, Partec no longer saw the need for having a partner and the JV was therefore dissolved. Partec decided to also carry out production in Lithuania, mainly for logistical reasons as the country is a convenient location for export to the East, West and other parts of the world.

#### ***7.4.1. Initiation and Purpose of Establishing the Joint Venture***

Establishment of the JV sales company went very quickly, as there was no heavy financial investment involved. However, the setting up of the JV for

manufacturing was a completely different story as the main issue was financing. Plans for manufacturing were an earlier decision, but serious work on setting up a JV manufacturing company began in 1993. Partec contacted several parties and ended up choosing a Lithuanian company called Silicatas, which later became the JV partner. Over a two-year period, both parties put tremendous efforts and resources into establishing this company. Silicatas produced two products in Vilnius, i.e. *silica bricks* and the older rock wool insulation material, and was a leading supplier of those products in the Lithuanian market during the Soviet era.

Several difficulties arose that the two parties had to deal with. Lengthy negotiations were carried out concerning:

- (i) the values of the partner's contributions;
- (ii) the organization of the JV; and
- (iii) the future of the 800 local partner employees when the JV was to be established.

With the collapse of the Soviet Union, the demand in the construction industry fell by about 75–80%. This was a real challenge as Silicatas had a social responsibility. As sales dropped sharply, it was unable to merely lay off the redundant employees. Silicatas had great difficulty understanding how a market economy functions. It found it difficult to understand the accounting system in the West, and what creates value. It was not easy for the local partner to adapt its knowledge and experience to the new developments. Throughout the process, Partec played a driving role in negotiations.

In the end, the challenges were dealt with in an appropriate manner. The said problems were not due to a lack of interest in cooperating on the part of the Lithuanian partner, rather Silicatas was used to a different system of managing and doing business. It required a lot of effort for the local partner to change its traditional way of thinking. Eventually, everything fell into place and the JV was established in autumn 1995. The decision to make the investment in the manufacturing line and to establish the manufacturing company went smoothly. Silicatas' technology was very old and of substandard quality, but it owned certain facilities and infrastructure of interest to the foreign partner. After intensive and lengthy negotiations, the parties established a JV in Lithuania with the aim of starting local production. For Partec, there were two main purposes in establishing the JV. First, it wanted to acquire knowledge of how the local environment and market operate and to find a partner who had good connections with the society, authorities and customers. The second reason was purely financial. By using existing infrastructures, investment costs could be substantially reduced in comparison with the cost of green field investment.

Silicatas was interested in the JV because it understood that its old-fashioned technology was of an inferior quality to keep up with advancements in the new market. It thus wanted to secure modern and high quality technology by engaging in a JV.

#### **7.4.2. Resources**

Silicatas contributed material assets such as land, buildings and infrastructure. In return it was compensated for a part of this in cash and for the major part in shares in the JV. The infrastructure included mainly industrial land, buildings, water and drainage, electricity, transformers, roads and other related facilities. This infrastructure was used by the local partner in production before establishment of the JV.

There were also two other shareholders that came from the financial sector. Further, there was a need to borrow money to complete the investment. The investment was made in 1994–1995, and during that period the environment was considered highly risky from a financial standpoint. A project loan from the European Bank for Reconstruction and Development in London was secured in addition to the shareholders money. Partec owned 48% of the shares, Silicatas 22%, and the financial institutions together owned 30% of the Lithuanian JV. Investment began in autumn 1995 and the JV went into production in 1997. The JV functioned very well the entire time. Production started in good form, sales were satisfactory, and the JV was selling in the three Baltic States and exporting limited volumes to a number of other countries.

Some time later, Partec learned that Silicatas was no longer interested in the JV. Silicatas' interest was of a short-range character and based on its need of cash to maintain the other parts of its production operations. Partec's interest in the JV was to become a market leader in the Baltic States. It was ready to put more effort and resources into strengthening its position further. After operating together for two years, Partec therefore bought 22% of Silicatas' shares and thereby became owner of 70% of the shares. The two financial institutions maintained their original shareholdings. From early planning to the execution stage, Partec had been the driving force in this JV. Silicatas contributed knowledge of the local circumstances in the planning phase, but once the JV was up and running Silicatas had little to contribute. It lacked sufficient knowledge in the technical field and marketing, and had no access to financial resources.

For certain strategic raw materials, Partec set up its own supply system. It identified potential suppliers and evaluated whether the quality of the materials

could meet the demands of the JV. At present, raw materials are supplied from local sources, and the company is to a lesser extent dependent on imported materials. Partec had overall responsibility for recruiting manpower. It recruited the managing director and head of human resources from Silicatas. In collaboration with these two leaders, Partec's employees worked intensively on various organizational issues. Its employees offered much support and direction to the local team with respect to recruitment, which was very much a team effort between the earlier local recruits and Partec.

Partec was fully responsible for the technology, i.e. manufacturing technology, technology for administrative areas, and the design of equipment for the manufacturing lines. It also managed the contacts with the various suppliers. A license agreement was signed between the Partec group and Silicatas, which helped the JV to get all the technology needed.

Market and customer contacts were actually one of the issues that dominated negotiation in the early stages. Silicatas had the customer contacts but did not perform any sales and marketing activities with the exception of answering telephone calls and letters from customers interested in the products. In the beginning of 1993, Partec signed an agreement with Silicatas to start a sales company, and 2–3 years later, Partec built up a sales and marketing organization according to its standards and took responsibility for the customer contacts. This sales and marketing organization sold local customer products imported from Finland and Sweden. Silicatas continued to offer its traditional products to its old customers. It was a sensitive issue as there was a certain element of competition. The high quality imported products were however priced at a much different level than the lower quality local products supplied by Silicatas. The sales and marketing organization was later merged into the JV.

#### ***7.4.3. Learning***

Silicatas was able to contribute here and helped Partec to learn about the local environment. This learning yielded knowledge of the structures and functions of local society, how the local bureaucracy works, and the division of responsibility and authority in local, regional and the national administration. The local partner had a lot of contacts at all of these levels, which proved useful in the planning stages and later in the setting up of the JV. It was very helpful for Partec to acquire this local knowledge.

Silicatas has also learned from the JV. It has learned what market economy really means, and how a company can create value, both for the owners and the customers. The JV had a long pre-planning period, during which the two

parties worked closely together for two years and which made everything in place. During this period, Silicatas learned a lot which was helpful in its other business activities. Learning had a positive impact on the setting up and operation of the JV. If Partec had not had the local partner, it would have lost time, and the cost of establishing the local manufacturing company would have been higher.

#### ***7.4.4. Network***

Partec managed to enter Silicatas' network. The contacts gained here involved people at local, regional and national levels of administration, as well as at the political level. Silicatas helped Partec to enter this contact network. Two or three years after the switch from the Soviet economy, very few people in Lithuania had a grasp of what market economy meant. During the Soviet era, political actors had been heavily involved in the economic sphere and there had been no clear division of responsibilities. It was necessary to meet the people at local, regional and national levels of government and to have the right contacts in the bureaucracy. Partec was required to give the authorities a clear explanation of its business plan and how it planned to implement it. Silicatas identified- and introduced Partec to the government parties and people with whom Partec had to deal and negotiate. Especially in the pre-planning stage, the two parties worked closely and spent a lot of time meeting with regional governments, and relevant ministers, local politicians and city leaders. The need for a local partner was very high due to the fact that Partec was one of the early investors in this region. When Partec committed to this investment in 1995, there was only one other major foreign investment that had been made in Lithuania. At that time, no-one was really aware of how the markets in this region operated. If Partec were to set up a company there today, it wouldn't need a local partner as it did before.

The JV has also helped Partec to develop contacts with suppliers of important materials who are able to deliver quality products to meet Partec's requirements. During the investment phase when many local companies were used, Partec had the advantage of their knowledge of good contractors, sub-contractors, and installers. These networks of actors helped the JV to function properly.

#### ***7.4.5. Performance***

Partec claims that the JV has achieved what it was expected to and in that sense, the company had been very successful. In the early stages, Silicatas made

essential contributions, but was unable to do much in subsequent stages. Consequently, Partec bought Silicatas' shares, and Silicatas received cash that it used in its other area of operations. Silicatas is also reasonably satisfied with the results achieved. In the absence of the JV, it would have had less chance of succeeding in the insulation business. By selling its shares in the JV, it received cash, which it used in the manufacturing of silica bricks, and has been doing quite well. Both parties now produce and sell building materials. Silicatas produces and sells silica bricks and Partec is mainly busy with insulation materials. The aim of Partec was to have a local partner in the JV only until it acquired the necessary market knowledge and had established a good base for starting production. Even Silicatas was satisfied with the results achieved. Comparing the aims of the parties to the results achieved, both parties were satisfied.

Another way of judging the success from Partec's point of view is its realization of an investment during a period when many people believed that Lithuania was not ripe for heavy investment. Partec succeeded in creating a clear market-leading position in all three of the Baltic countries in a manner that was quite satisfactory from a financial standpoint.

#### ***7.4.6. General Environment***

In Lithuania, the administrative bureaucracy inherited from the old socialist systems still exists and has an impact on the JV. Their laws for the economic sector are insufficient, and finding a competent legal advisor is not always easy. It took time and effort to understand their legal system, as it was constantly changing and developing. It was developing in the right direction as the ambition of the government was to adopt the European Union's commercial legislation. When starting from nothing, implementing corporate law, competition law, and other laws to guarantee ownership, success and other important issues, is not something that can be done overnight. Therefore, understanding the country's legislation and adapting all agreements to this incomplete and changing legislation, was a big challenge. Performing all of the operations in a bureaucratic system and obtaining all approvals was also a challenge. Only after one had first built a factory and production lines, could one submit an application to the relevant authority for permits. Before committing any money, Partec wanted to know that once the investments were made production would be permitted to operate. It was a real challenge to get the bureaucrats to understand why Partec did not want to make any investment unless it could obtain a permit in advance.

In the end, Partec managed to receive a preliminary decision in advance and was promised that there would be no change between the preliminary and the final decision. Partec faced a lot of uncertainty, but was able to overcome this as it had strong support from the government. To modernize its economy, the government realized that it had to encourage JVs from the West. Partners from the West were transferring modern technology and could provide safety measures in the buildings. There was a strong interest on the part of government to see the success and realization of JVs.

Securing financing for the JV was also a major challenge. Partec collaborated with financial institutions created by the European and Nordic countries to encourage sound development in ECE countries. However, these institutions were also bound by normal banking restrictions on their activities. The financial institutions also sought as much security as they could possibly find. Arranging pledges and mortgages as security for the lender was also a big challenge. In the first place, the legislation was not there, and when legislation did come into force, the institutions to handle the legislation were not in place. Everything took time and Partec worked extremely hard to organize things over a period of at least two years.

A well-developed market structure was absent in Lithuania and therefore the role of distributors/dealers was not always clear, which created constraints as well as opportunities for the operating firms. In a developed market, firms must follow the market rule regarding how to distribute products and services. Failing such accommodations in the system, a firm may need to gradually cease operating in the market. As the Lithuanian market was not organized, actors had a great degree of freedom. Firms were free to make their own plans regarding how to satisfy customers and build a strong position in the market. Partec's early entrance into the Lithuanian market offered it a better chance to develop an effective distribution channel comprised of motivated and goal-oriented salespeople.

When the JV started up, Partec found the local staff quite inefficient. As a result, it was eager to find the right people for the right position. It sought people with professional skills, a positive attitude and the right mentality. Partec tried to recruit those employees who would be motivated in their work, and ready to take responsibility for their actions, and not just expect that someone else should sort things out for them. Because of this, the JV hired younger people. Partec was also pleased with their performance, as they have shown a lot of professional development and had the right attitude from the start. In the early days, there were very few people who could speak English. One criterion set for people who wanted to assume a leading position in the JV, was that they should have either a basic knowledge of English or be committed

to learning it. All of the people who were engaged in leadership position were involved in language education. Intensive language courses in Great Britain and training in Lithuania were conducted on various occasions. Once the company overcame the language barrier, it was able to communicate with its employees directly without engaging interpreters, which was a big step forward. From a cultural standpoint, there was a very open attitude towards adopting a market economy mentality and being prepared to take responsibility.

A major problem arose during the pre-planning period of 1993–1995, as there were difficulties in getting the local partner to understand how the market economy functioned. There were also problems in the boardroom as the local partner had little to contribute and was not really able to understand Partec's view of running operations. Their way of doing things was different and the cultural differences between the parties were at times very prominent.

## **7.5. Accel Share Company in Lithuania**

Accel produced and sold climate system components and electronic equipment for the car industry. The company had customer contacts and sales in Sweden and product development and production in Lithuania. During 1994–1999, the company managed to double its sales, from 15 to 30 million Swedish Crowns. Accel is a family firm, owned equally by the two family members.

### ***7.5.1. The Purpose of Forming the Alliance***

The purpose of forming the alliance on the part of Accel was to access a well-educated but comparatively low-paid manpower. Another purpose was to find a local partner who had the capacity to directly help with product development. The foreign partner took the initiative to the collaboration. The managing director of Accel visited Poland and Lithuania in 1993 to explore the possibility of establishing an alliance in one of these two countries. Accel readily came in contact with a promising and a suitable business firm in Lithuania, where the cost of production was also found to be less compared to Poland. The local partner had acquired skills through a previous collaboration with a military institute during the Soviet period. An alliance was therefore formed and registered in Lithuania in 1994, and production started in 1995. The local partner acquired 51% ownership while the rest went to Accel.

### **7.5.2. Resources**

Accel was responsible for sales, customer relationships, and purchasing of all components for the production in Lithuania. The local partner, Terra, was in charge of production and product development. Even in the case of product development, however, Accel Shore Company (ASC) was involved, as it contributed by collecting and communicating important information from the customers. It also had ideas and made suggestions for product development. As it had lengthy experience in the car industry, it was able to suggest which products the alliance should concentrate on, and which niche it should exploit. The local partner produced on the basis of Accel's specifications, which were originally received from the customers. The foreign partner actually collaborated with the customers in preparing the specifications which were sent to Lithuania for production purposes.

The alliance started with a moderate amount of capital in 1995 and grew steadily. The partners took a loan for the factory building. The local partner invested in kind, i.e. a part of building and equipment, whereas Accel contributed only cash. Accel contributed with car industry know-how including mechanical engineering and logistics. The local partner had technical skills of a general nature and was capable of developing any electronic product. If someone had a query, Terra would test it and produce the product according to the requirements. If it concerned a specialized product, such as for the car industry, Terra may need help understanding the specification. Accel helped the local operation to translate the car industry specifications and to begin thinking from the customer's point of view.

Electronic components were bought in Sweden but there was plan to procure them from other countries like Malaysia, Hong Kong, China, Taiwan and France in the near future. According to the new plan, the local partner would be in charge of purchasing. A main contribution of the Lithuanian partner was the arrangement of technicians, as skilled technicians in the field were available locally. Both parties contributed to production technology as they reviewed operations and went through different projects together. When a project was undertaken, the partners discussed how the project would be carried out, which technology would be used, and which equipment would be required. The partners often tested different alternatives before taking such decisions. All of these tests were carried out in Lithuania.

ASC engaged three people in Sweden who helped the alliance with different kinds of testing on a regular basis. These experts traveled several times to Lithuania to support the local technicians. As mentioned, the local partner was skilled in electronics and sometimes helped Accel in solving problems related

to this area. Terra was also responsible for research although the alliance did not yet conduct extensive research. Being responsible for marketing and customer relations, Accel sold the alliance's products in Belgium, Holland, England and Sweden.

### **7.5.3. Learning**

Accel learned a lot from the cooperation although this had not been the initial aim. It was surprised by the Lithuanian partner's technical expertise and ability to swiftly adjust to the customer's needs. Accel gained important technological know-how from its partner. It also learned that planning and implementation do not always work as they should in such a collaboration. Therefore, the partners concentrated on these issues from the very beginning and came a long way in solving such problems. Accel realized that growing too fast was not good and therefore looked for moderate but steady growth that the partners would be able to manage to their full satisfaction.

The Lithuanian partner learned a substantial amount about the car industry. The mutual learning had a positive impact on the cooperation, as the partners learned how to properly manage communications between them. This made it easier to agree on matters and also to effect long-term planning. Previously, Accel had been giving clear instructions and advising the local partner on how people's way of thinking in the car industry is. After developing a good number of projects together, the local partner began to understand the concept of identifying and satisfying the customer's needs.

### **7.5.4. Network**

Accel developed contacts with other firms through its contacts with the local partner. One such contact concerned a local firm that produced electronic micro sockets. Accel cooperated with the firm to develop solar sensors for the car industry. In 1999, it bought around 0.3 million solar sensors from this firm to supply to the car industry in Europe. The local firm was one of the few ISO-certified firms operating locally. In selling to the car industry, it was almost a requirement that products have ISO certification. Accel also established contact with another local firm that supplied several parts to the Lithuanian operation. However, the foreign partner was not able to develop useful contacts with the government authorities because all official matters had been a function of the local partner. Similarly, the local partner lacked contact with other Swedish firms and the international customers.

### **7.5.5. Performance**

Performance met or exceeded the expectations the partners had anticipated from the alliance. In a relatively short time, the partners succeeded in building a company that could manufacture products according to their expectations. The alliance has also delivered these products to its customers since 1996, with high customer satisfaction. As operations were managed properly and sales grew steadily, both firms earned a good return from the Lithuanian investment.

Terra was a small firm in the car industry and its market share was marginal. However, the partners' joint market share became considerably larger when they started collaborating. The alliance has also managed to produce inexpensive and competitive products of a very good quality. For example, in the past, power modules were produced for the SAAB 900. The alliance now produces improved power modules for SAAB 903 and 905. It has also received orders from many other firms for the supply of power modules. Solar sensors are another niche product, also developed for the car industry. The alliance has been a regular supplier of solar sensors for different VOLVO vehicles and is also considering starting to sell sensors to SAAB. Accel wants to continue collaborating with the local partner and has no intention of leaving the alliance even if it has other promising alternatives. Both partners displayed a strong interest in continuing with the relationship and were also seeking other joint projects together. The alliance offers attractive working conditions and pays its employees higher salaries than local firms offer.

After eight years' of operation in Lithuania, the partners are now considering moving some production to Belarus but no decision has yet been taken on the issue. The reason for the partial move is cost, because, in recent years, salaries have increased considerably in Lithuania. The partners want to move less qualified jobs to neighboring low cost countries but are in favor of retaining qualified jobs in Lithuania since the local employees have developed the required level of competence.

### **7.5.6. General Environment**

The impact of the general environment on the collaboration was substantial. Lithuanians are mainly Catholic and are trying to make up for what they missed, with respect to having been denied their religion and other aspects of their culture, during the last 50 years. The people still have vivid memories of

how the Soviet Union ruled and managed Lithuania. There is nothing lacking in their level of competence, but the speed of doing things is a bit slow. To survive in the international competition, it is required that firms act quickly so that buyers do not have to wait unnecessarily for the supply. Planning has been a concept missing from the local culture. Accel expended much effort in this regard to make the local partner realize the importance of making plans and keeping commitments made to the customers. Accel worked with the local people to develop supply schedules and to meet the deadlines. As the local people had less respect for time and meeting deadlines, the foreign partners had to go in and do additional work to save the company's goodwill. This extra effort increased the cost of production but helped the local people learn how to deal with customers.

The local people were not accustomed to following up their work and therefore many times failed to detect and rectify their mistakes. The local culture encouraged production but was less concerned with quality and improvement. Negotiations with customs officials, who could delay clearance of imported goods without sufficient reason, were difficult and time-consuming. The partners handled such problems by conducting long-term planning and negotiations with the concerned authorities. Most of the time, they succeeded.

The level of technological development of the two firms is more or less the same. However, Accel needs to transfer its branch know-how as practiced in the car industry. There have been two types of language difficulties: one is related to the difference in languages spoken by the partners, the other to industry jargon. The local partner had the general technical knowledge but no idea about the car industry, e.g. the customer's way of thinking, placing orders, handling complaints and resolving problems. Accel helped the local partner to understand how the car industry works and how buyer-supplier relationships are established, maintained and further developed.

## 7.6. Ericsson in Croatia

Ericsson, a leading international partner in telecommunications, is well known for its advanced systems and products for fixed and wireless communications in both public and private networks. It is also an important supplier of electronic defense systems. The dominant area of operations in the consumer segment is mobile telephones and terminals, where Ericsson has gained a position as a leading supplier with a strong brand in the digital mobile phone market. The company traditionally offered a broad range of mobile phones and

has been a supplier for three digital standards, GSM, PDC and TDMA. In 2000, Ericsson also began to deliver mobile phones for CDMA, making the company a supplier for all digital standards in the world. With its strong international presence, Ericsson possessed unique knowledge of market conditions in all parts of the world. It had sales of 216.6 billion Swedish Crowns and a 1998 pretax income of 20.9 billion Swedish Crowns.

Ericsson has 100,000 employees with representation in 140 countries. More than 95% of Ericsson's sales originate from outside of Sweden, making it the most international of all companies in the industry. The company's strength builds on a worldwide presence, world-class research and development, a broad product portfolio with strong solutions in all customer segments, and its leadership in wireless technology and mobility. All of these factors help to differentiate Ericsson from its competitors. Ericsson's unique global presence was established over 100 years ago. As early as the late 1890s, Ericsson had operations worldwide, including countries such as China, Russia and Mexico. Ericsson offers total end-to-end solutions for both mobile and fixed networks, including a range of services. Ericsson also offers solutions for emerging markets created by the trend toward convergence of telecom and datacom, and of fixed and mobile services. Ericsson combines its unique position in wireless and its competence in building robust and reliable networks with a strong commitment to the latest technology. It operates in Russia with a wholly-owned company and has representative offices in a number of other countries in the old Soviet Union. The only country in Eastern Europe where it has a collaboration is Croatia. Ericsson has always concentrated intensely on technical development. Annual investment in research and development has in recent years ranged from 15% to 20% of sales. In 1998, Ericsson invested US\$3.7 billion in R&D, corresponding to 16% of sales. More than 23,000 employees in 23 countries are active in research and development.

### **7.6.1. Motives**

Ericsson took the initiative to get involved in the collaboration in Croatia due to the local company's long experience and high expertise. The company was involved in export and had a substantial local market share. Ericsson chose Croatia because it knew the local company from the past and had a long-term relationship with them. Another reason was that the Croatian government was making big investments in building up the telecommunications infrastructure at that point of time. Investment began in 1993 and reached extremely high levels in 1995. The local government wanted to engage mainly a local company in

this building process. Through the collaboration, all three partners, i.e. Ericsson, the local shareholders and the government, had the chance to benefit. However, the establishment of the joint venture went through a complicated process. Negotiation started in early 1994 and it took a year to reach the final agreement. This was the first privatization project of its kind in Croatia.

### ***7.6.2. Establishment of the Collaboration***

In 1995, the former, state-owned enterprise “Nikola Tesla” was transformed into the joint company “Ericsson Nikola Tesla”. The company is located in Zagreb, the capital of the Republic of Croatia. In connection with the Croatian government’s privatization program, Ericsson acquired 49% of the shares and thus became the major single shareholder. Current and former employees owned 50%, and the Croatian Privatization Fund owned the remaining 1% of the shares. The original Nikola Tesla was founded in 1949 and was the largest specialized manufacturer and exporter of telecommunications equipment in the former Yugoslavia. Their close collaboration with Ericsson dated back to 1953, when the first license agreement was signed. Nicola Tesla, which was a state-owned company, was granted a license to manufacture Ericsson telephone equipment. The local company paid royalties for the license, an arrangement that continued until 1995. In 1958, Nicola Tesla exported its first exchanges, and is one of Ericsson’s oldest licensing partners. Over the many years of collaboration with Ericsson, three generations of switching equipment were manufactured, installed and put into operation. In 1977, the partners signed another license agreement, this time for the production of Ericsson’s digital AXE exchanges.

In 1995, Ericsson found the market more mature and considered pursuing closer collaboration. The Croatian government wanted to play a role in the new collaboration and a JV was thus formed. Ericsson bought its equity from the local government who disinvested a part of its ownership in Nicola Tesla to implement its privatization program. The government offered employees of the old Nicola Tesla the opportunity to buy shares. Some of the previous employees sold these shares, which were bought by local banks. Local ownership became scattered, with no one owning more than 5% of the shares. In the alliance, Ericsson got the post of managing director, finance director and factory manager. During the communist period, the local company had access to certain Ericsson technology but in a restricted form. Relations between the local company and Ericsson, both on technical and commercial levels, were always good.

### **7.6.3. Resources**

When collaboration began, there was a need for reorganization of the company. The existing technology was old and concentrated on a limited and regulated market. The company had many employees but overall performance was not satisfactory. There was a need to upgrade the technological skills of the company. The local government also accepted and supported the changes. The government had a strong interest in the development of the company and a high-ranked government official sat on the board of directors. The JV was one of five exporting firms in the country. There were nine board members in total, of which five were from Ericsson. The chairman was also from Ericsson, and appointed by the annual general meeting. Ericsson had the responsibility of modernizing company facilities and developing competence, which successively grew. Some new products were on the market already in 1996 alongside older offerings. Some key components, which were used in the final products, were being produced in the factory. The JV specialized in sales, project engineering, software development and manufacturing. The major products included AXE digital exchanges for fixed and mobile networks, transport networks, public mobile telephone networks and microradio links. Products were exported to Ukraine, former Yugoslavia and a number of other Eastern European countries. The JV collaborated with Ericsson's subsidiary production units in Hungary to gain the advantage of economies of scale. The expectations the local people had of Ericsson comprised mainly the access to high technology, earning a good profit, and substantial exports.

In 1998, about 40% of the company's products were exported. In 2000, the number of employees totaled about 1200. When Ericsson entered the company as a partner, this number had exceeded 1800. A part of activities was later sold. Some of the surplus of employees received early retirement, and all of these changes took place with the consent of the local government. It was easy to find technically skilled workers in the country. Sixty percent of the total number of employees had university education and 10% held a master's or doctorate degree. All together, there were seven Swedes working in the JV, mainly involved in marketing and management functions. Local technical staff were often sent to Sweden for on-the-job training, and there was almost always somebody from the JV in Sweden for official purposes. Quality control was also an important function of Ericsson and there was a design center set up in Croatia for this. The JV's activities were not restricted to specific products, but could in principle involve the manufacture and sales of any Ericsson product. However, in practice, production decisions were taken centrally for better coordination of Ericsson's global marketing strategy. In the beginning, there

were some difficulties regarding financing of operational costs because the rate of interest on loans taken locally was very high.

#### ***7.6.4. Learning***

There had been improvement in the local shareholders' understanding of the share market. It became easier for them to accept a moderate disbursement of profit and reinvestment of a part of the profit into future development of the company. Ericsson has developed skills that could be applied in other countries, not only Eastern Europe. In the beginning, the local press was rather critical toward the JV. However, over time, Ericsson learned how to handle the situation and the attitude of the local people gradually became quite positive regarding the activities and performance of the joint company. In order to increase the company's professional and business expertise, they organized their own training sessions. These activities helped the employees to learn about teamwork and how to develop personal responsibility. As a partner in the company, the local government got a clear idea of Ericsson activities as well as modern telecommunications systems. A representative of the audit authority was in touch with the company every few months, which provided them useful insight into the telecommunications business. The government had benefited from the JV in many ways, and major learning took place concerning the attitude of the employees. There was more openness and people learned to think in a different way and not be suspicious of each other. The local employees adapted a Western way of seeing things and the Western culture of delegating responsibilities to the right person.

#### ***7.6.5. Network***

For many years, the company had collaborated closely with the Faculty of Electrical Engineering and Computing in Zagreb. In this collaboration, the JV paved the way to the world's leading telecommunications technology, and the Faculty was the breeding site for an expert workforce. The local design center of the JV participated in many research and development projects at the corporate level in Sweden. Within the Ericsson corporation, the JV was given the responsibility of software development for traffic control and traffic signaling subsystems. This opportunity gave the JV technicians a good chance to develop useful contacts with many experts in the field of telecommunications. The Croatian company also carried the responsibility as the regional

center for network/project engineering, customer services, and also as a provider of all these services to other Ericsson companies in ECE.

The JV developed a market network throughout the Russian federation. For more than 40 years, it served the Russian market and was also present in a dozen other Eastern European countries. The company appeared either as an independent trade partner or in collaboration with Ericsson Corporation. For all these years, it supplied Ericsson products that had been adapted by local company specialists to meet the requirements of the customers' telecom networks. Due to its wide contact network, the company was also able to sign its first GSM contract with Republic of Belarus in 1998.

#### **7.6.6. Performance**

The general competence of the employees and modernization of the company proceeded satisfactorily. In the beginning, it was difficult to communicate as very few people could speak English. In recent times, English was spoken as the official corporate language and the employees were able to work with computers. Technology had changed, thus advanced products could be manufactured in the company. Collaboration between Ericsson and the local company was very close. Both partners have a strong interest in the development and success of the company.

The environment and working procedures of the company have largely been changed to comply with Ericsson's management philosophy. Decision making has been transferred from *top-down* to the operational level to increase overall efficiency. The local people noticed a great change concerning openness and access to information. The employees knew what was happening inside the company and why. The local, as well as other Eastern European telecommunications markets had increased considerably by the end of 1999. In the last few years, expansion has taken place in terms of increased sales and return. During 2000, the importance of the JV increased substantially in the Ericsson corporation. The local company had the responsibility of finding communications solutions for ECE. In 1999, it started working with modernization of communications in the Romanian railway network. In late 2000, the JV concentrated on getting similar projects in Uzbekistan and Ukraine. In 1998, pretax profits were around 40 million Swedish Crowns, which was down a bit from the previous year due to the Russian economic crisis. Many of the Russian customers did not make their payments in 1998. The process of establishment in the country was not easy and Ericsson considered the overall performance of the alliance quite satisfactory.

### **7.6.7. General Environment**

Croatia was a part of Yugoslavia for more than 45 years. On June 25, 1991, it became a sovereign independent country. Croatia has a population of 4.4 million and an area of 57,000 square kilometers. The GDP growth for 1998–1999 was 6% with an annual inflation rate of about 3.7% and an unemployment rate of 20%. The Croatian telecommunications market was experiencing intensive growth. In the period 1991–1995, a total of 0.8 million telecommunications lines had been installed. In the five years that followed, this number rose to two million. The Croatia market has high potential, as the density of telephone users has been relatively low there, making huge market growth in a short time possible. The only problem was the weak economic conditions. The people at large did not have the capacity to pay for telephones as they had enough trouble acquiring more basic needs.

It was not that difficult to borrow money but the rate of interest had been quite high. The banks operating in the country were mainly of local origin. The banking system as a whole was undergoing transformation. There were, however, some German banks and foreign insurance companies. In 1999, it became possible for foreign firms to establish wholly-owned companies. Earlier a local partner had to be involved in cases of foreign investment. At first, the local people have difficulty trusting foreigners, and one must develop personal relationships otherwise no business can be done. The local people make deals with people whom they trust. In doing business in Eastern Europe, a firm must get to know its customer. A relationship is required before they trust each other. There is no doing business in Eastern Europe spontaneously. Developing contacts and personal relationships are considered vital factors to succeed in the region.

In Croatia, the language is problematic. Since the use of English is not very common, one needs to know the local language. It is important to find a local person who can deal with administrative hierarchies and bureaucracies. This is a very complicated part of business in all of Eastern Europe. The system of *top-down* decision making left from the communist period was still in existence in Croatia. Some changes had occurred but the speed of change was relatively slow. The privatization of government companies started recently in Croatia and a German company recently bought 35% of the state-owned telephone company. This led to great turbulence at the annual general meetings regarding the issue of reinvestment and disbursement of profits. The local people were interested in extracting as much profit as possible because the concept of share market and reinvestment are new in Croatia.

## **7.7. Ragn-Sells in Estonia**

Ragn-Sells is a wholly-owned family company working in the field of waste treatment, which operates throughout Sweden. Established in 1966, Ragn-Sells now operates in over 70 locations across Sweden. Its customers include households, municipalities and industry, and it is well equipped to deal with different kinds of problems to minimize the impact of waste on the environment. Ragn-Sells' areas of operation include: waste minimization; sorting-at-source in the home and in the workplace; recycling; recovery of recyclable materials; energy extraction from materials which cannot be recovered and safe disposal of the waste left at the end of the process. Ragn-Sells offers a wide range of services to industry. Services to municipalities may include operation and management of water and sewage treatment plants, parks, green areas, street cleaning, etc. The company operates a number of treatment plants for residual products and waste. Its activities consist of the sorting and processing of residual products as well as the treatment and controlled tipping of waste. In collaboration with two large Swedish universities, Ragn-Sells runs a foundation for research and development in the areas of residual products and waste in Sweden.

In the last 15 years, the company has also concentrated on the hazardous waste such as chemicals and oil, and recycling. When the company was started, the number of employees was 30. In 2000, this number had grown to around 1500. The company owned around 900 vehicles and had an annual turnover that had climbed to 1.6 billion Swedish Crowns by the end of 1999, with an annual growth of about 20%. The company also operates in Norway, Estonia and Denmark. Its first foreign investment was made in Norway in 1989. The Norwegian and Danish operations are wholly owned by Ragn-Sells. The company had done marketing research in Latvia, Lithuania and Poland, but had no plans to invest in other Eastern European countries, although they had received many inquiries, especially from Russia. To invest in other countries, would require both financial resources and the skills to handle managerial and cultural differences. However, Ragn-Sells did have worldwide experience, as a consultant, and carried out assignments in Europe, Asia and South America. It provides specialists in analyzing environmental impact, environmental accounting, waste planning, waste treatment, etc. The company has 25% of the property clean-up market. Its major competitors are municipalities and two other foreign firms. Ragn-Sells is engaged in a large number of collaborations with many small companies in Sweden. These collaborating firms are permitted to use the Ragn-Sells symbol (logotype).

### **7.7.1. Establishment of the Joint Venture**

The company had no plans to invest in Estonia, but rather happened upon the collaboration by chance. As a part of the Helsinki Agreement, at the end of 1980s, representatives from the Baltic States visited the neighboring countries. Ragn-Sells received visitors from local governments in Estonia who visited one sewage treatment plant and were impressed. In 1991, one of these district administrations, Haapsalu, asked Ragn-Sells for help with refuse collection and street sweeping. There was some political instability in Estonia at that time and the country was in the process of becoming independent. Ragn-Sells accepted the offer but Haapsalu had financial problems. They came to an agreement that local staff would take care of the marketing and housing facility, and the Swedish company would be responsible for production and production-related resources. A joint venture agreement was signed between the Estonian government and Ragn-Sells on a 50/50 ownership basis for 1991/92. The JV has a board of directors, with representation by Ragn-Sells and by the finance secretary and governor of the district on the local side. Operation of the JV began in October 1992. Ragn-Sells was responsible for arranging used vehicles for refuse/garbage collection and for providing skills and know-how in waste collection and computer facilities.

### **7.7.2. Resources**

Ragn-Sells was looking for a qualified Estonian-speaking person in Sweden to be responsible for the Estonian operation. It was believed that such a person could easily understand the local mentality and could act as a bridge between Sweden and Estonia. This was necessary to minimize cultural differences between the partners. There were many Estonians living in Sweden who came during the Second World War. Ragn-Sells advertised in a Sweden-based Estonian newspaper and eventually came in contact with a graduate from the Royal Institute of Technology. This person was very competent and spoke both Swedish and Estonian but knew nothing about collection and disposal of waste. He was therefore educated by Ragn-Sells and became the chief executive of the Estonian JV. Most of the employees of the JV were Estonian immigrants who had the required expertise. There were certain cultural differences between the local and immigrant Estonians. The Estonian immigrants were Western-oriented, while the local people were drawn more to the Estonian culture. Initially, there were 45 employees in the company but the number dropped to

20 by the beginning of 2000, partly due to the introduction of better equipped vehicles and partly due to increased efficiency in the company. Further, the JV was initially responsible for street lighting but this function was later taken over by the municipality. Ragn-Sells invested capital in the beginning and the local partner made investments in kind. After that, the JV generated its own income and no further capital from the owners was necessary to run the operation. The Swedish company concentrated on developing the overall activities of the JV which led to a reorganization of local operations.

The managing director of Ragn-Sells became directly involved in the Estonian operation and provided active support in the form of regular consultations and visits to the local operation. This support was extremely necessary for the local chief executive at that time as it gave him an experienced person with whom to talk over problems and exchange ideas. The JV's activities were concentrated to the district where it was located. The chief executive has dual citizenship and no other Swedes worked in the JV permanently. However, Swedish personnel came to the JV from time to time to transfer knowledge to the local employees. This knowledge concerned, for example, management of the computer systems, buying new vehicles, introducing new techniques in waste disposal, and developing routines for financial matters. Provision of support was a continuous process but the major help extended was that during the establishment of the JV. Ragn-Sells helped the Estonian operation to gradually develop full-fledged economic competence. No separate financial department was established in connection with the formation of a wholly-owned company in Tallinn in 1994. All such functions were carried out by the JV. This service was an additional source of income for the JV. The chief executive of the JV also became the head of the Estonian subsidiary. The double role of the Estonian chief executive has never been questioned, it was instead considered a strength since the JV and the subsidiary were able to collaborate effectively. There was collaboration at all the levels, and the companies were duly charged if they received services from the other.

The JV had both local and foreign competitors. There were a few Finnish firms in the market and these firms had both a physical and linguistic advantage. A German firm was also active in the market. Its strategy was to expand through acquisition of local government firms. Ragn-Sells also acquired some small local government firms as a part of the subsidiary. Their contacts with the authorities gave them a good image and access to important actors in the market. In the beginning, almost all of the employees of the JV traveled to Stockholm for training, which lasted from one to four weeks. Later on, the employees received on-the-job training.

### **7.7.3. Learning**

The JV gave Ragn-Sells insight into how the market functioned. It was also able to realize what the people wanted concerning the environment and management of waste products. Ragn-Sells learned how to do business in a country that was previously under communist rule. The local people knew little about the environmental aspects, but after the establishment of the JV their awareness of environmental protection increased greatly.

Ragn-Sells conducted a survey on waste collection and disposal in Estonia and suggested some solutions in the form of a report. This report was helpful for the local government in understanding the problems and in taking measures to comply with European Union regulations. The need was great but the government was trying to handle it within its limited capacity. The awareness developed by Ragn-Sells constituted important support for the government in taking initiatives on environmental issues.

### **7.7.4. Network**

The board of directors met four times a year. There was also a management board that was responsible for the JV's day-to-day operations. The local chief executive and Ragn-Sells managing director were very active and collaborative in the management board. The Swedish company developed valuable personal contacts with the government authorities, which helped them to expand business in Estonia. Their contact with the government gave them special status in the society and they received recognition in the form of an award for their outstanding contribution to the environment given to them by the country's president.

The local directors of the board served as a network and were very helpful in establishing useful contacts with other important people. The first finance minister of Estonia was also a board member. Board members often offered important suggestions for the development of the operation. In the beginning, Ragn-Sells managing director visited Estonia twice a month, but the frequency of these visits gradually decreased to once a month. All minutes were written in English and Estonian, but conversations at the operational level were held exclusively in Estonian. The language used in the boardroom was English, but the local chief executive would sometimes speak Estonian with the local people in an effort to clarify things and save time.

Based on the existing contacts in Estonia, Ragn-Sells was also trying to get a strong foothold in Lithuania. The managing director of the Swedish company visited different firms there and also received visitors in Stockholm. Ragn-Sells

wanted to grow in the country using their own resources because they were familiar with the market and had already established sufficient contacts. If they were to enter the Lithuanian market, however, they would prefer partnership as a part of the strategy.

Ragn-Sells found a growing market in Estonia and therefore decided to expand their existing business network further. They advertised seeking manpower and five people were selected out of 120 applicants. The selected applicants had a good knowledge of English and Russian. The new employees were given the responsibility of setting up offices in their respective areas and starting work according to the guidelines. Ragn-Sells provided supporting materials and financing.

#### **7.7.5. Performance**

At the beginning of 1994, Ragn-Sells evaluated the local operation in Estonia and was very satisfied with the progress. The JV's turnover grew from 2 to 10 million Swedish Crowns by the end of 1999. The market was stable and dependent on the economic growth in the region. There was no discussion regarding further investment in the JV. The government, on the other hand, had no special interest in keeping its shareholding in the company. A possible withdrawal by the government would however require a long bureaucratic process. Ragn-Sells expressed an interest in acquiring those shares if the government should decide to leave its ownership. There was no conflict when Ragn-Sells decided to establish its wholly-owned company in Estonia. The local partner was not interested in getting involved in this venture due to the huge investment required. The local partner was rather happy because it created extra income for the JV for its financial services to the wholly-owned company. In the initial stages, it was important for Ragn-Sells to share risk and also to gain access to local skills and resources. The local chief executive was an important asset for the company as he spoke both Swedish and Estonian and was motivated to work there and develop the company. He was now based in Tallinn and visited the JV once a week. A separate manager was recently appointed to operate the JV. In fact, Ragn-Sells did not differentiate between the JV and the wholly-owned company as concerns management and operation. The only difference was related to the ownership structure and the maintenance of different financial records. Employees of the two companies were equally qualified and efficient.

The wholly-owned subsidiary was a very successful investment and the total number of employees rose to 150 over a period of six years. Ragn-Sells was the

biggest company in sanitation and disposal and had a 50% share of the Tallinn market. The Swedish company did not press the local people to apply its marketing policy blindly. Local staff were permitted to think freely and implement the marketing strategy they thought relevant for the market. Of course mistakes did occur, but Ragn-Sells and the local people learned from these how to work more efficiently in the future. There were no big cultural differences. Everything worked quite smoothly. There was some talk of implementing the successful strategy from Estonia in other Baltic countries, but the Swedish managing director did not consider it to be that easy since there was the language factor as well as cultural differences between the countries.

#### ***7.7.6. General Environment***

There was no direct cultural conflict when the alliance was established. The managing director of Ragn-Sells did however notice a number of cultural differences between the partners as he was involved in the process from the beginning. He worked in the company for more than 35 years. The local people were proud of their work and wanted to manage things by themselves. On one occasion, the local chief executive said that he had much to learn from Ragn-Sells' managing director. The local people did not like this attitude and questioned why the chief executive, who was an Estonian, could not do the work by himself. There were no legal restrictions to having fully foreign-owned companies in Estonia, but there was an official requirement to involve local representatives in the board of directors. It was, however, not necessary that these representatives be government officials, but it was entirely possible to select one's own people from those with an Estonian background. Early entrance into this country's market was very advantageous for Ragn-Sells as it helped them to become acquainted with local people and establish goodwill. When the country badly needed foreign support, Ragn-Sells was there. This early presence gave them respect and trustworthiness. They succeeded in selecting qualified, efficient people for the board of directors. This gave the company useful contacts with the local elite, the relevant authorities, and government customers. There was initially no market for waste collection and disposal but the market gradually matured. No-one was interested in this field as it was a low status job.

## Chapter 8

# Alliances in Slow-Adapting Countries

## **8.1. Husqvarna in Russia**

The Swedish company, Husqvarna, is about three hundred years old producing mainly kitchen appliances. The main products of Husqvarna are the white goods including freezer, refrigerator, washing machine and oven. In 1996, Electrolux, also a Swedish company, bought Husqvarna since Electrolux's major business involves in selling kitchen equipment. The Forest and Garden Section of Husqvarna exports to about eighty countries in the world. In the important markets for its products, Husqvarna has fully-owned subsidiaries, but in some countries it uses private distributors. The total number of the subsidiaries is about thirty. Husqvarna had a JV in Slovenia and a fully-owned Production Company in Brazil.

### ***8.1.1. Motives***

The aim of establishing the JV on the side of Husqvarna was to build a strong position in the Russian market in the field of chainsaws. Since Russia offered a vast market, it considered early presence important to have a competitive advantage. Husqvarna even counted the local support significant in marketing the products as the possible local partner might have crucial contacts with the main buyers and a good knowledge of the market. The aim of the local side was to secure high quality products for the local Forestry. There was a total dissatisfaction to the buyers on the quality of locally made chainsaws.

### ***8.1.2. Negotiation and Establishment of the Alliance***

Husqvarna was already operating in Russia through a JV. It has been operating there since 1970, i.e. in the period of old political and economic system. Through its participation in an exhibition in Russia in 1989, Husqvarna

developed some useful contacts. The exhibition involved Forestry Machinery where a lot of customers from the Russian Forestry participated. In this exhibition Husqvarna received a request from the Russian Government to establish a JV for the development and production of chainsaws. The Russian customers were not satisfied with the locally produced chainsaws and therefore were seeking quality products from abroad. In this connection, a group of officials from the Russian Forestry Machinery Corporation visited Husqvarna in Sweden.

Consequently, Husqvarna set up an internal group of five people to consider whether a joint company can be established. This group had the responsibility to survey the Russian market and to investigate the possibilities of working together in this specific field. The outcome of the internal investigation was positive. Both parties had the first meeting 2–3 months after the exhibition, and came to the conclusion that a JV for producing chainsaws would be established. From the Russian side, a sister organization of the Russian Technology Forestry Organization (RTFO) participated. RTFO was at that time manufacturing products such as tractors, hydraulic loaders and chainsaws for the Russian forestry market. RTFO was already aware of Husqvarna's products because Husqvarna was selling chainsaws in Russia and they were found to be of very good quality. A RTFO's subsidiary, named TSNIME, became the local side to negotiate a JV deal. TSNIME is an engineering company, which develops and produces forestry machines for the Russian Forestry. Initially the local company employed 4,000 people, but in the year 2000 the company was split into several sections, and became medium-sized.

Two meetings in Sweden and two other meetings in Moscow were carried out to reach a final agreement. Lawyers were also involved in the negotiation. Husqvarna had a British lawyer and TSNIME had a Russian lawyer. The negotiations went smoothly. In the negotiations, the marketing issue was not raised and discussed, as the Russians were saying that marketing was not a problem. They claimed that the duty of the JV should only be to produce and send the products out. This was how the Russian company worked before the change came. The market-oriented system in Russia was introduced in August 1991, and by that time all the documents for the JV were signed. The JV was established near Moscow in a city called Khimki and started operations in January 1992. Husqvarna and TSNIME own 50% each in the JV. Husqvarna has the MD post. And this gives the MD authority to decide if the board directors become 50–50 on some issues. The major political change in Russia took place just four months before the JV started to operate. However, it did not have much impact on the operations of the JV in the beginning. Husqvarna considered Russia a very important market for itself.

According to the agreement, Husqvarna would supply the technology, all the different components to start assembling the product, and some specialists from Sweden. Moreover it would also supply one assembling line, which is exactly the same type as what Husqvarna has in its factory in Sweden. TSNIME would also supply the manpower to assemble the products, some management people, accountants, buildings for the assembling line and storage facilities. But as the storage facility was not enough they decided to build another store. In sum, Husqvarna was responsible for the technology and TSNIME for the buildings and the manpower to do the work. Chainsaws seem to be very simple, although it has to be used in the forest under different weather conditions; during the summer under 30 degrees hot weather and in the winter when there is one meter of snow and 30 degrees below zero. It is a very complicated product and it is very important that the quality is of a very high level.

### ***8.1.3. Resources***

When Husqvarna started the JV in Russia, in the beginning the old system was dominating the discussions and the company had a lot of problems with that. For the Russians it was very difficult to understand the need of marketing. The Russians thought that they should just make production and deliver the products to the forest organizations that needed the products. Earlier, the factories usually received orders by the higher authority and therefore were engaged only in production, and no question of marketing did arise. When the market economy was introduced in the early 90s it was difficult for the Russians to adopt the marketing philosophy in doing business, i.e. to sell their products. They tried to stay in the same system as before and consequently got involved in financial and managerial crises. People working on financial matters had difficulty understanding each other. In the accounting department of the JV, one Russian was in charge of the accounts and he needed to collaborate with an expatriate controller visiting Russia twice a year. Due to differences on basic financial issues, two separate financial statements were prepared.

In the beginning, the JV was responsible both for production and marketing, but, after a short time Husqvarna realized that it would not function and therefore changed the arrangement of the joint venture. Whenever there was a discussion in the board on how to develop the JV's market, TSNIME could not understand and accept the necessity to invest any money for marketing. But it was not acceptable to Husqvarna, because it was convinced that the JV would not achieve any growth without marketing efforts. Foreign competitors who

entered the market were marketing their products aggressively and the JV was passive in this regard. So after three years of joint operations, Husqvarna separated out the marketing function from production and since then two companies were operating — one for the assembling of the products and the other for marketing. It was difficult to operate production and marketing functions jointly because the Russian partner could not understand that one had to spend money in marketing products. And therefore, the local partner was not ready to pay its part of the marketing costs.

Husqvarna works jointly with the Russian partner in production and assembling, but not in the field of marketing. The marketing company is fully owned by Husqvarna. This was a necessary solution as it was difficult for the Russian partner to realize the need of marketing. It was TSNIME that was expected to contribute market knowledge and contacts for selling the products in the local market. However, it could not contribute the expected marketing and market contacts services to the JV.

Husqvarna has some contacts which can be utilized in the procurement of raw materials, as it produces 1.2 million products per year, which is 5200 products per day in the factory in Sweden. It buys a lot of magnesium and aluminum from Russia. The JV buys wood from the forestry in Russia and sells to the Swedish and Finnish Forest Companies in Sweden. In the JV it is Husqvarna, which is responsible for procurement because it makes all the purchases.

In Russia the barter business is widely spread. RTFO has a lot of trees and it prefers to have Husqvarnas products in exchange. So Husqvarna has agreed to buy wood from Russia and to send chainsaws in return. That is how the barter exchange is taking place. This covers about 25% of Husqvarna's business. It is the Husqvarna's marketing company in Russia not the JV, which is responsible for this barter business and purchasing. All the purchase details are prepared in Sweden and Husqvarna sends them to Russia. The board of directors is responsible for the financing of the JV.

The local partner is mainly responsible for recruiting technicians, engineers and production-related people. Certification, importation and other local issues have been the functions of the local partner to deal with. If such issues or problems are not managed appropriately, it can be really difficult for the JV to operate. These are very important contributions made by the local partner to the Joint Venture. Husqvarna does all engineering functions, manufactures main products as well as components in Sweden and sends them to the JV in Russia for assembling. Employees of the local partner visit the Husqvarna factories in Sweden twice per year to receive clear instructions as to how the assembling should be done. They are also provided with the necessary information and are

allowed to observe with their own eyes how Husqvarna works in all its production lines. Besides, Husqvarna also makes quality control and sends one expert to Russia, who randomly chooses a few products and checks their quality and also takes some products back to Sweden for testing. This helps the local people to see how Husqvarna works and assembles the products. In the very beginning, Husqvarna brought all the Russians, who were engaged in assembling, to Sweden so that they would be able to see and learn how it operated. Further, Husqvarna is responsible for R&D, marketing and customer contacts in the JV.

#### ***8.1.4. Learning***

Husqvarna had the ambition to learn the local market and as how the Russian society functioned. The JV produces one component in Russia which is a special part of chainsaws.

Husqvarna has learned that operating in Russia is a slow and a time-consuming process. It has learned that it needs to have more patience in doing business in Russia. It has also learned to deal with the barter system in overcoming foreign currency crises. TSNIME has to some extent learned what marketing is but still not convinced on the applicability of the concept in the Russian context. It has also learned that Husqvarna has very high quality products and advanced quality control systems. From time to time visits by the local employees in the Swedish factory have given them the chance to have a clear idea about the product development and necessity in maintaining product quality all along. Further the local partner has learned to efficiently assemble different parts to make the final product in Russia. Both parties have learned how to work together with a partner or organization with a different background and possessing a complementary competence. Joint learning has a positive impact on the operations of the JV because the partners have found it to be easier to communicate and understand each other since they have started to operate jointly.

#### ***8.1.5. Network***

In the beginning, TSNIME helped Husqvarna to develop market contacts and specifically with the Forestry Organizations. In every district in Russia there are Forestry Organizations and today Husqvarna has good contacts with all them as its customers. TSNIME has also helped Husqvarna to develop contacts with the

authorities during the introductory phase. In 2000 Husqvarna had all those necessary contacts established and are functioning properly. With the development of the contacts with the Forestry Organizations, it is able to sell its products. It is also selling to the governmental institutions such as the electricity authorities, oil companies, road construction organizations. It was not that easy to handle all relationships with the government authorities. The local partner initially had difficulty coping with these problems but could gradually develop necessary contacts with the concerned authorities which were also introduced to the foreign partner.

As most components come from Sweden, it is necessary to obtain various clearance certificates from the Import authority in advance before the imports are made. Husqvarna has to obtain a certificate for each type of product that it is selling. Concerning certification, the Russians do not accept the European standard, because they have their own standard. TSNIME has provided substantial support in this regard through its contacts with the authorities for the issuance of import certificates. Another help by the local partner concerns negotiation with the taxation authorities as the majority of the products are being imported. Even closer contacts with the local municipality, in which the JV operates is crucial. It is important that local connections function so that streets and the infrastructure around the factory can be kept in order.

#### **8.1.6. Performance**

The JV has not fulfilled Husqvarnas expectations due to economic instability in Russia. The country has not been able to develop the situation very much during the last ten years (1992–2002), however Husqvarna hopes the situation will improve and the JV will achieve better results. So far the JV has not shown a positive result. The JV faced different problems concerning marketing, management and financial issues and procedures. Due to the miserable condition of the middle class, the overall purchasing has not increased, and therefore, the sales target of the JV cannot be met. The sales of chainsaws is highly dependent on the economic condition of the country. What took place so far in the JV, can be considered as an investment rather than a return on investment. However, Husqvarna likes to continue with the JV because it believes that it is very important to have close contacts with important markets like Russia. If the situation improves, which Husqvarna firmly believes it will, it can utilize the already established contacts significantly in securing better results and considers Russia to be a potential market for future growth and development. It also believes that the investment in Russia was well motivated.

Husqvarna is ready to establish another Joint Venture in Russia with the current or any other partner, if it gets a good offer with a sound proposal. It has already received a few offers for collaboration, but likes to go slowly with those options considering the changing situation of the country.

### ***8.1.7. General Environment***

A number of differences can be observed between the Russian and the Swedish way of managing and doing business. In Sweden, people are more used to teamwork, while in Russia an authoritarian type of leadership and management is practiced. Once the Board of Directors makes a decision it has to be implemented at the lower level and it is very difficult and unthinkable to make compromises and modifications. In Sweden, if it is noticed that it is not reasonable to implement a board decision as it is, certain modifications can be suggested and be implemented. Such a change is very tough and even difficult to discuss with the Russians. When Husqvarna is confronted with such problems it reports back to Sweden so that the cases could be taken up in the next board meeting for adjustment. Several board decisions were discussed again and changed with one exception. And this caused to split the JV's activities into two companies, one for the assembling and the other for marketing. Husqvarna tried to work in Russia as it does in other Western countries, i.e. to set up shops for all of its products together with the owners of those shops. These shop owners are like distributors who sell Husqvarna products. TSNIME did not want to give support to the private shops owners. It was expecting that Husqvarna would do everything centrally without involving middlemen. Whereas, Husqvarna wanted to do it separately for each shop on the basis of individual shop's requirements. Through the establishment of the marketing company, Husqvarna finally has appointed distributors in the various districts and offers them the necessary support. Husqvarna plans to organize courses, to offer training and to give practical guidelines to the marketers which was difficult for the Russian partner to understand and to accept.

Husqvarna still has a big problem with the old employees in the JV because they are not interested to learn English. However the young people, who are engaged in the assembling factory, welcome changes and some of them already speak English. But, when some of the employees do not show any interest at all to learn English, one cannot do very much about it. However, such employees are not fired, because in the JV things are handled carefully and the Russian executives are authorized to decide which people they would like to employ and to let go. As a result the communication between Husqvarna and

the JV does not function well. The foreign partner lacks the opportunity to have informal contacts with the MD and the technical director due to the language barrier. This shortage has a negative impact on the development of the JV as quick and appropriate decisions cannot be taken and implemented. In the board meetings, the partners meet two times a year, which Husqvarna does not consider enough. Day-to-day contacts and the possibility of regular discussions are considered necessary for the growth of the JV. The communication problem with the Russian MD and the technical director made Husqvarna incapable to help the JV with the level of production which has been very low since the inception of the joint operation. However, Husqvarna is not at the moment very much interested to have a higher production efficiency in Russia because it can produce those products in Sweden and at the same price, as Russia is no longer a low production cost country.

However, in the marketing company, Husqvarna could hire younger people and younger directors who have become very successful. To establish a fully-owned company in Russia is very difficult now. To have production in Russia, one needs to have good Russian people who can manage the operation efficiently. It is very difficult for foreigners to manage the company alone, because they will have problems with the Tax and Imports authorities as they require a different kind of skill and network.

To finance the JV, Husqvarna borrowed money from foreign sources, because of the high interest rate and inflation in Russia. Moreover, the Russian Banking system has not been safe. To give an example, 30% of the banks have gone bankrupt and many people have lost money due to the financial crisis. In August 1998, the situation for all businessmen was very difficult in Russia because the Russian currency lost its value drastically against the dollar making imports very costly. Before the devaluation one could buy two Russian chainsaws for one Husqvarna's chainsaw. But after devaluation, one can get six to seven Russian chainsaws for one of Husqvarna's. The cost and price of locally made products fell sharply compared to the imported products. All necessary components have been imported from Sweden and paid in dollars, which made Husqvarna products very expensive in Russia. It would have been much better if Husqvarna could produce its components in Russia. But it could not do that partly due to non-availability of local supplier of quality material and partly due to production inefficiency in the JV. Husqvarna initially gave credit to its dealers but lost a lot of money for non-recovery. To adapt with the local environment, it has now adopted a restrictive credit policy.

Legal aspects and government policies also affect the operations of the JV. The JV has experienced a tough time regarding taxation as the tax is very high for manufacturing companies in Russia. Even customs duty in Russia is

exceptionally high. All these costs make Husqvarna's products expensive and less competitive. Moreover, according to the Russian law, companies should have a different bookkeeping system. So all Swedish companies operating in Russia have to run two separate systems for reporting their economic activities — one to the Russian Taxation Authorities and the other to the Swedish Taxation Authority.

The local employees, both in the JV and the Husqvarna's Marketing Company, manage most of the contacts with the Russian Authorities. There are a lot of problems in their contacts with the government. The authorities are said to be always trying to find problems or faults in the daily operations. In the case of certification, instead of focusing on the product quality and other important product features, the authorities concentrate on how the application forms are completed and how the columns should be filled in. If some minor information is missing or any form is not properly filled in, they refuse to give any clearance certificate for the product. The applicant is required to fill the forms and apply again which is time- and resources-consuming, causing delays and increase in costs.

In general, factories in Russia are of a very low standard and therefore they usually come in for government scrutiny. Visitors from the Russian authorities come to the JV for inspection and certification. For every inspection, local companies have to pay to the inspecting authorities. But the JV's factory is very clean, the quality control standard is very high, everything is well documented and the company can provide all the details as well as facts and figures of its operations. But whenever the Russians are in a visit they are allowed to do the inspection. This aspect of the general environment affects Husqvarna's operations in a positive way, because the Russian partner and people think that Husqvarna has a high quality technology.

Due to the economic situation it is a little bit more difficult to be successful in Russia than in other countries. There are more economic problems, which hamper the operations of foreign firms in Russia. Government regulations are also other factors but that has much to do with the economic situation in the country. If the economy in the country improves the government regulations will also be easier to handle and the authorities will be more open to accept the Western style or model in doing business.

## **8.2. XYZ SC in Russia**

The XYZ company has two main product areas. One is ventilation, the main product area and the second is a profile which contains a very wide assortment

of products programs for the construction industry. From 1994–1998, sales increased from 2,3 billion to 3.3 billion Swedish Crowns. This clearly demonstrates that the sales growth was on average 10% per year. Profit during the same period has increased, from 169 million to 285 million Swedish Crowns, the highest result achieved in the history of the company. The number of employees in 1994 was 1880 and reached 2,655 in 1998 out of which 1,016 were working in Sweden. XYZ is owned by Danish, German and French institutions, and the Danish institution owns the majority of the shares. Within the Danish Institution, the employees operations fund owns 9,4% and the Municipality Pension Insurance fund owns 8.9% of the shares of XYZ. In the international market, XYZ has gradually strengthened its position. When XYZ started its operations in Russia, the Russian entity DEF was owned by two Swedish firms. ABC owned 15% and XYZ owned 85% of the company. Finally, XYZ bought the 15% of the shares and owned the Russian operations 100%. The jointly-owned company was located in St. Petersburg.

### ***8.2.1. The Motives and Initiation for Forming the Alliance***

The main reason for forming the cooperation was that ABC had a sister company in Russia, and XYZ considered this experience to be an advantage for its operations. The experience of ABCs sister company in the Russian market was assumed to be a useful asset for forming the collaboration by XYZ. ABC contacted XYZ in 1996, when it knew that XYZ was interested in the Russian market. It could clearly see the possibility of a cooperation in the local market. The aim of XYZ to operate in Russia through a joint venture was to find a market for its products, believing that there was a large potential market. By that time ABC was already selling XYZ's products in the Russian market. XYZ accepted the proposal and both the companies collaborated through a jointly-owned company. This is a somewhat different type of a joint venture as it is a Swedish firm, which collaborates with another Swedish firm in the Russian market. There was no need for a permit to build the joint venture. Two Swedish companies joined hands against the Russian authorities, converting one existing firm to form another Russian firm.

### ***8.2.2. Negotiations and Meetings***

It was clear to the partners as to what every partner expects and should do in the joint venture. Therefore it did not take long to conclude an agreement. XYZ

also as a majority shareholder could make any decision. But, even before going to the issue of majority shareholder issue and who should make a decision, both parties could easily reach an agreement as how to share the work and how the collaboration should look like and should operate.

### ***8.2.3. Resources Contribution***

ABC contributed its knowledge and experience of the Russian market, mainly customer contacts and XYZ contributed its production know-how. Combining their knowledge, experiences and efforts they expected to do a successful penetration in the market. XYZ employed people to do the work, which were getting instructions from the management meetings. Both parties were represented on the Board of Directors. Because XYZ had a major shareholding, it could influence as to how the work should be done and how the collaboration should function. ABC also contributed its experience, on how to deal with the various administrative offices, e.g. Customs and Tax Authorities. It was very critical to handle bookkeeping and other market related issues. XYZ was responsible for purchasing, and DEF was doing the actual purchases following XYZ's instructions. XYZ and ABC financed the JV operation 85% and 15% respectively, in proportion to their ownership of shares. In sum, the parties main contributions were that, ABC contributed its knowledge of the Russian market and the Russian legal structure, and XYZ mainly contributed its product know-how.

### ***8.2.4. Learning***

XYZ has learned that it is difficult to operate in the Russian market, mainly due to difficult administrative and bureaucratic set up. It therefore considered the knowledge and experience of ABC to be advantageous for the collaboration. However, when it started to operate in the market, it learned that there was less need for collaboration. Because it could learn much by itself in a short period of time, it acquired the necessary knowledge and there was no need of having a collaborating partner anymore. It acquired the knowledge of how to do business in the Russian market and it was also the reason why it bought the company and became a 100% owner during the summer of 1998. It had a very positive collaboration with ABC and what it has learned was very useful in its future operations. It learned how to deal with matters of a practical nature. Examples of such practical works include contacts with the authorities,

contacts with lawyers and formulating and writing contracts with local people. It could also learn the market and customer structure, from the very first day it started to operate.

### ***8.2.5. Network Development***

The collaboration was a very good platform in order to develop a network of contacts. Contacts with different authorities; lawyers who can deal with the complicated Russian law; and with the customers and other business relationships were of greater use. With the help of these contacts, it could manage relationships with the Customs and Registration authorities in an appropriate way. XYZ learned that doing something for the first time was very difficult, but when it is done repeatedly it gets quicker and becomes easier. ABC dealt with the Customs Authorities for a long period and it was very easy for them to take care of that part of their common operations. XYZ was introduced by ABC to its contact net. XYZ gained a lot from ABC's knowledge and experience and it managed to successfully exploit ABC's network. ABC on the other hand, has also gained and learned from XYZ's knowledge and experience and also to some extent penetrated XYZ's network.

### ***8.2.6. Performance***

The results achieved so far in Russia, largely fulfilled XYZ's expectations but XYZ could have wished for better results. After two years of operations, the JV's sales was not large enough; it only started to develop a structure and felt that it had a good platform to start. XYZ considers the collaboration to be successful, because the local partner has helped it to start the company. To get it registered, it has used and taken advantage of ABCs' knowledge as to how to manage and lead a company in Russia. To register a company and to import products in Russia is a very complicated and time consuming process. One has to visit a good number of authorities in order to get approval, such as police, fire brigade, authorities for social, pension and customs. XYZ utilized ABC's experience to go through those processes. It could also come into contact with some important customers with the help of ABC.

However, it is difficult for XYZ to assess whether the results achieved fulfilled ABC's expectations or not. The Russian market being very difficult to penetrate and to acquire market shares, one would have wished to have better sales. There is no need for further cooperation on the part of XYZ as it has

learned how to do business in Russia. XYZ could and would continue the cooperation, in importation, authorities contacts and transportation which can make its costs cheaper. But, that is not the same as having a joint ownership. XYZ also collaborates today with ABC, but it doesn't jointly own the company anymore. It still hires premises of ABC and the latter has continued to sell XYZ's products in Russia. There was no bitterness from ABC's side when XYZ bought the whole alliance. Both companies had collaboration before the formation of the joint venture and even after it was bought by XYZ. XYZ decided to buy the company fully as it is easier and faster to make decisions. Decision making in a JV can be difficult and time consuming. When XYZ declared that it wanted to buy the company, ABC agreed without raising any objection. The solution was acceptable to both parties. Even from the very beginning XYZ had the option to buy the company and to own it fully up to 100%. There was an idea from the very beginning that it would take over the company, when it would judge that the right time had come to do so.

Another most positive result of the alliance was that with the help of the ABC, XYZ entered the Russian market very fast. Many critical problems and issues were solved with little effort. Examples are practical issues, such as contact with offices, lawyers, and different authorities, and experiences of agreements. The knowledge of ABC as how to do business in Russia was very advantageous and timely for the JV. It was more administrative issues that ABC managed to deal with during the alliance operations.

### ***8.2.7. General Environment***

It is very difficult to do business in Russia with the current rules and regulations that can be interpreted in very many ways. The legal structure does not function. The taxation and customs regulations are also very complicated making them difficult to understand. The taxation system changes quite often. It is not any easier for Russian lawyers and financial advisers because there are no clear guidelines and a large number of exceptions are provided in the existing laws. This made the JV operation difficult as everything took time to work out. The company needs to put much time and resources in administration to deal with such activities than to concentrate on marketing and sales. There is evidence that some companies pay tax while others do not. One can avoid taxes by keeping good relationships with the authority or by utilizing the insufficiency of the laws.

Relationships with the Customs Authorities are other problems to be dealt with. To import goods to Russia is very difficult. In the first place one has to

have an import permit which can be difficult or time consuming to get. Once the license is obtained, the process has to pass through the customs which is also a long process and really time consuming. What makes it so is that there are many steps which have to be carried out. One has to visit several authorities within the customs, to get approval of the various documents and to make sure through repeated checking that the right goods are imported. These processes are very comprehensive and therefore take time. If something is found inaccurate by mistake of a certain official, it can take a very long time to get it rectified and acceptable.

Business in Russia is done on personal relationships. It is more important to know the management of the company than to have a good product to sell. Personal relationship with the customer is of great importance in the Russian culture. To develop such a relationship, one must work and make efforts from a long time perspective — it is not something that can be done in a week or a short period. It can be developed by meeting customers over a long time. If one does not previously know the customer on the basis of other old relationships, one has to work successively to get to know the customer more and establish relationships.

Another factor which affected the JV was that, Russia has changed very fast, but people have not changed at the same pace as the environment. There are young people in the organization who think in a modern way. But, they have always in their whole life got instructions from their bosses as to how to solve all problems and implement all decisions. But now suddenly one has to take his own initiatives and to conduct business and related operations, which means that one has to be very creative and this is very difficult for the Russians. If someone does not tell them exactly what to do, they become sort of paralyzed and they give priority to their own work. It is the board of directors which give directives and instructions. But, if someone works under full responsibility and authority, which a leader does, he must be able to take his own initiatives, and its a difficult job for the Russians. It does happen in rare cases, but they have only just learned to do what they are told. Consequently, it was difficult for the XYZ to manage the company. XYZ however tried to bridge this gap through education and competence development. It did this continuously both in formal and informal ways. XYZ had a number of meetings in Russia in order to influence the local employees and the management. The result was positive especially in the case of the young generation. Even the local MD had difficulty in taking initiatives. XYZ did its best to change his ways of managing the company and initiative taking.

The working morale, the working culture, concept of time and concept of punctuality differed very much between Sweden and Russia. A Russian needs

a very dominant leader to work efficiently. In Sweden people are having an inspiring team leader, but a Russian needs one who can tell him exactly what he should do. The Russian mentality is rather to find excuses or explanations than doing things. To deal with this cultural difference and its impact, the company did its best to find a strong and dominant leader who can manage or lead the organization. The company accepted and adapted to the customs, manners and practices which existed in the market. The JV employed a Russian manager who on his part tried to control the company strictly. He had to be very clear and concise, as he knew that the employees are not self-reliant and can't manage without instructions.

Cultural differences were also manifested in the relationship among the Russian and the Swedish managers. Specifically, the Russian style is to be dominant and the Swedish style is to be a democrat — a sort of inspiring. To be a good and successful Russian leader one has to be dominant. The Russian MD therefore required clear policies, instructions and directives from the Swedish management as to what he should do and what he should not. Further, the Russian crisis which started in August 1998, had a negative effect on the alliance operations. All prices increased as the ruble's value decreased drastically against the dollar. Cost of all imported goods increased by 400% and consequently, XYZ was on the way to stopping its operations in Russia.

### **8.3. Holmen in Russia**

Holmen, the foreign partner, is a financially strong and internationally oriented company. It is organized into four business areas; Holmen Paper, Iggesund Paperboard, Iggesund Timber and Holmen Skog. Holmen Paper products are used in newspapers and magazines. The products of Iggesund Paperboard are used in the most advanced packaging for food, cosmetics, pharmaceuticals, chocolate, etc. Iggesund Timber produces customized special products for the wood-working industry. Holmen Skog is responsible for the supply of wood to the Swedish units and manages the Group's forest holdings of some one million hectares. The Group has around 5,300 employees. Holmen's principal market is the EU and the turnover was 16,6 billion Swedish Crowns in 2001. Profit after tax for the period January–March 2002 amounted to 743 million Swedish Crowns and the return on equity was 14,4%. Newsprint and magazine paper as well as paperboard are Holmen's core businesses.

Holmen Skog, the company involved in the joint venture, is responsible for the procurement of wood for Holmen's Swedish mills and for managing the group's forest holdings. The business comprises harvesting in Holmen's own

forests, and wood trading which involves the purchase of wood from private forest owners and its sale to Holmen's or other forest companies' mills. Estonia is the country where Holmen Skog has its only wholly-owned subsidiary in Eastern Europe.

### ***8.3.1. Motives***

Holmen's choice to get established in Russia was influenced by several positive factors. The main purpose to establish JV in Russia was to get access to local timber at a lower price. The idea was very simple. If there was an establishment in the country, Holmen could buy forest lands and transport timber to Sweden. This investment appeared very attractive, as it would give Holmen a competitive edge in the international market in respect to cost and access to good raw material. It never planned to have local manufacturing of forest products in Russia. The company found a huge potential and therefore believed in a long-term growth of the Russian market. There was also the possibility in earning a good profit as the local supply of timber was abundant.

### ***8.3.2. Establishment of the Collaboration***

The choice to establish a JV was not purely a voluntary decision. There was a legal requirement to have a local partner for any kind of foreign investment in the country. From the business point of view, Holmen even considered it important to have local interest in the company. There was an uncertainty in the market and it really had no idea how to operate in a country like Russia. In fact, the proposed investment in an ECE country, was to be the first of its kind in Holmen's history. Cultural differences between the countries and lack of knowledge in the Russian language, left no other alternative than to seek for a local companion. Even though there was no obligation of a local partnership, Holmen would consider a JV form of investment to get into the Russian market. The potential partner's local know-how and contacts with the relevant authorities were considered highly important for a successful investment in the country.

To establish the JV, Holmen sought a local company, which had relevant competence and wide experience of the Russian market. However, the inquiry process was short as Holmen could easily find a suitable local company, which was also interested to get involved in the alliance. YND, a Russian contracting

firm, was already known to Holmen as they did business together before. The Russian company was buying and selling timber both locally and to the international market. Holmen found YND's competence and local know-how highly corresponding to its requirements of being a local partner. The JV was thus established in 1994 with three partners. The third partner was KAV Industrial, a Swedish company, which entered the JV by the initiative of Holmen. This Swedish partner also had a business relationship with Holmen. The reason for KAV Industrial's involvement in the alliance was to come up together to build a Swedish equity ownership of at least 75%. According to Russian law, an approval of at least 75% of the shareholders was required to liquidate a company. Holmen itself could not have so many shares for different reasons but chose to involve KAV Industrial. In the JV, Holmen acquired 52% of the ownership while the other two partners had 24% each. The JV was located in the city of Novgorod, situated by the side of the river Volga. After the establishment, the JV bought a large amount of forestland in the area through a privatization auction. A government authority originally owned the land but sold it as part of Russia's privatization program. All the partners apparently had the same goal in the venture as they were interested in getting access to timber at lower cost. Holmen considered the partners' similar goal as an important prerequisite for a successful collaboration.

### ***8.3.3. Resources***

There was a Swedish MD and other Swedish personnel in the JV to run the operation effectively. Attempts were made to train the local employees and to build up a joint operational team based on a combined local and Swedish management style. The Swedish MD left the JV after two years and the function was handed over to local personnel. However, a Swede continued to work there as in-charge of purchase of timber. During the establishment of the JV, Holmen was the main financier as the other partners' contributions were made in kind. The financial situation of the company gradually weakened due to its inability to generate any operating profit. Discussion on further increase of the share capital had not been taken up because Holmen did not see any future of the company and therefore lost interest in supporting with further working capital. Due to its only buying function, the venture had no sales force. The employees were mainly involved in forest management, cutting and transporting timber to Sweden. Holmen could decide how the operation would be run and be organized and supervised. In fact, it had total control on the overall business activity.

### **8.3.4. Performance**

The JV faced operational difficulty right from the beginning as there was a lack of appropriate timber in the region and partners were in conflict as how to run the operation. There was no profit in the company and the continuous loss became a burden for the Swedish company. Holmen decided to withdraw from the collaboration as they did not find any potential in the market. In 1999, Holmen therefore sold its equity ownership to an international company, which was owned by a Russian domiciled in a foreign country. The Swedish company considered leaving Russia for several reasons:

- (1) The JV was no more cost effective as it had to pay new types of taxes and other expenditures which were not included in their initial calculations. The company was not sure about such costs and was anxious not to continuously face similar problems in the future.
- (2) There was management conflict as the partners failed to solve their day to day problems. Apparently the partners understood each other but in fact, the differences were deeply rooted in the culture. The partners, especially the foreign firm, was not at all aware of such differences and their negative impact on the operation.
- (3) The JV could not find the right timber in the area in which the Swedish firm was looking. No proper investigation about the kind of timber available was done before the establishment of the operation. If the right timber was available in the region, the foreign firm might try to solve the other problem in some way. But that motivation was never there.
- (4) The company suffered losses all the years and there was no possibility to improve the situation in the near future.

### **8.3.5. General Environment**

The political and economical environment had been more or less unstable in the 90s. The recent drastic fall of the Russian currency did not make the situation better. Many foreign companies, especially, Americans, entered into the Russian market immediately after the collapse of communism to get the first mover advantage. But a lot of them got a bitter experience and found it difficult to operate in the country. Before entering the market, Holmen made market research, particularly regarding Russian law. It found legislation's were very complicated and confusing. Moreover the laws had been changing all the time, which made it almost impossible for foreign investors to get a general view of the situation. It had no clear picture of how the tax system functioned

and costs involved in doing business in Russia. However, Holmen intentionally overlooked the risks involved in the political and economical factors, as it did not have any intention to market or sell some products in the country. It was just a buying company and therefore had no customers, but only suppliers.

Russian corruption was internationally known and was really a critical problem for the foreign investors. Most firms used to solve these problems by engaging Russians, mainly as local partners in the businesses. Another problematic area was the cultural differences, both at the national and organizational levels. Russian is the only language, which is used in all conversations. It is therefore important that foreign firms employ interpreters. There is always a risk of misunderstanding between partners in the absence of direct communication.

## **8.4. Korsnäs in Yugoslavia**

### ***8.4.1 Motives***

The main motive for Korsnäs to establish a factory in Yugoslavia was to increase sales for products manufactured in Gävle. It was very important for Korsnäs to find a suitable partner in Yugoslavia due to problems within the country and the difficulty to deal with government and local authorities. A local partner was therefore desirable, who would understand and have better connections with local authorities and the local market. It also gave the JV a better insight into the local culture, something which was very important in a country with a large number of different ethnical groups. The JV gave a local identity and anchorage and was very important at the beginning. However, there was no legal obligation to include a local partner in the operation. Another motive to enter Yugoslavia was to establish production in the developing countries. It was strategically important for Korsnäs to be one of the first companies to start production in the East European countries.

### ***8.4.2. Establishment of the Joint Venture***

The collaboration started in 1997. There was some production of paper bags in Yugoslavia before the JV was established. But these paper bags were made by hand and no advance technology were used. Two major reasons for it were the low labor cost and lack of capital to invest in machines. The JV in Yugoslavia is located in Vojvodina, the northern part of Serbia. Korsnäs has the majority

ownership 71% in this JV, the remaining shares are owned by a bank and a local company. It was very important for Korsnäs to get the management responsibility in this joint ownership. The undeveloped technology and other problems in the country gave Korsnäs a competitive advantage and the company rapidly captured 50% of the market.

#### ***8.4.3. Resources***

To minimize the cost of investment, Korsnäs moved machines from factories in Western Europe to the JV in Vojvodina. The factories in Western Europe had become more effective, therefore old production lines could be moved. Korsnäs increased the efficiency by investing in modern facilities in Western Europe while transferring the semi-modern machines to Eastern Europe. The whole operation is conducted and managed by the guidelines of Korsnäs. Through this practice, they could use the machines twice in two environments under different market conditions. Machines and technological development were not the only things provided by Korsnäs. Its contribution to the collaboration also comprised of capital, training to the employees and raw material which was bought mainly from the Swedish market. Korsnäs carried out development and research on products and technology. The local partners' contributions to the joint venture were land and building.

The majority of the employees were recruited by the company in Yugoslavia and were then trained by Korsnäs personnel. The company employed 122 people in 1999. The only manufacturing function of the company was to convert paper into paper bags, thus the technology applied was quite simple. The marketing function was carried out by the JV itself. But it was very important that the marketing strategy was developed and executed in a West European style because a major part of the production was exported to other parts of the world, such as Russia, Greece, Romania and Africa. Due to instability in Yugoslavia, the JV had to seek more and more export markets and leave the local market unexploited.

#### ***8.4.4. Learning***

The collaboration gave an incitement for the partners to learn from each other. The JV provided Korsnäs with a chance to learn how to establish and operate in a country, far different from Western Europe in so many aspects. The local partners on the other hand got access to western techniques especially in connection with marketing efforts and sales management. Preparing budget and business planning were totally new concepts for the local partners as well as for

the local employees. Another important learning by the foreign firm was the knowledge of developing good relationships with the government, decision makers, influential people, customers and so on. No firm, however good the quality of product they have can't survive unless they have built up a workable network with different categories of important people. They have learnt a lot about a potential market and the pattern of doing business in a new world where competition and marketing were totally new concepts. However, there was no interest from the local partners to learn about production and technology innovations. The main object of these companies was to see that products were duly sold and they had a good return from the operation. Korsnäs regarded financial weakness and the absence of proper engagement by the local owners as two major problems in the JV.

#### ***8.4.5. Network***

The JV developed its own contacts both in the country and abroad. Although Sweden and Yugoslavia have wide cultural differences, it was not a problematic issue as the chief executive of the JV was well known to the local culture and could fluently speak Serbo-Croatian. The JV had to develop useful and long-term contacts with local influential people to run the operation but the local partners could not make an important contribution in this field. However, their formal presence in the JV gave it a local identity, which indirectly helped to create a local network around its activity. Sales of the products in the local market was limited partly due to political instability and economical crisis. But the local market has a potential, therefore the existing contacts would be of great help when the situation changes. Korsnäs presence in the country helped it to develop new contacts with customers in other countries, especially Russia and Greece. It has strengthened its position in the customer networks and thus obtained a useful competitive advantage over other multinational competitors.

#### ***8.4.6. Performance***

The war made it difficult for the JV to fulfill the expectation of the partners. There were periods when the factory had to be closed. Thus, there was sometimes no income at all, but there was always cost, as they had to pay the permanent employees of the company. The partners involved in this JV were said not to fulfill each other's expectations. Korsnäs thought that the local partners would be more active and interested in the development of the company and help them solving problems that occurred. The local partners

gave the impression of only being interested in the amount of return they might earn from the company. The total performance of the JV was not as important as the cash flow to them. There was also a difference of opinion between Korsnäs and the local partners on how the operation would run. But it did not become a major issue as the foreign firm's professionalism and its market-oriented approach proved to be convincing and effective. Furthermore, the foreign firm was the majority owner and also in control of the local operation. The sales of the company went up to SEK 125 million in 1999 which was slightly better than the previous year.

#### ***8.4.7. General Environment***

Yugoslavia had been involved in a war for the nine years during late 80s and early 90s. The war and the problems connected with this, such as sanctions, short supply of products, trade restrictions, etc. caused an economic crisis for the country. These economical problems made it difficult to obtain a sufficient amount of hard currency, which was necessary to operate the company smoothly. It was therefore important to have or develop contacts with the people who could help the company in obtaining this currency. The main method of payment in the country was barter, which required products against products instead of involving money in the transactions. The lack of hard currency and the unwillingness to use money as a means of payment could have something to do with the legal problems in the country. The policy of the government was to increase the control over companies. If the government could control the companies, they could control the cash flow and if they had access to the cash flow, they could control everything. This was a major problem for foreign manufacturing companies in this country. The government was also constantly rewriting the law and it was not unusual that laws became outdated and new laws were put in every week. The governmental involvement and so many new laws made it difficult to manage the company efficiently. Management had to be very flexible and adaptive to cope with the changes within the country.

The preliminary negotiations with the authorities were of great importance. In order to receive all the necessary documentation the company had to have good connections within the local bureaucracy. These connections could speed up the establishment process by minimizing the influence of "red tape". People with power used to slow things down in order to obtain unfair advantages from the companies. Bribes were another problem. Important documentation can be lost if a company does not pay bribes or lacks good connections with the local

authorities. There was also a high degree of cultural differences among the employees of the joint venture. Thirty-nine different ethnical groups were living in this area and almost every group was represented in the company.

## 8.5. Stora in Russia

Stora Enso is an integrated forest products company producing magazine papers, newsprint, fine papers, packaging boards. It also markets softwood, pulp, timber, forest and other special products. In 2001 Stora Enso had sales of 123 billion Swedish Crowns and approximately 15 million tonnes of annual paper and board production capacity. The Company employs some 43,000 persons in more than 40 countries. Stora Enso works mainly in the business-to-business environment and serves both large and small customers such as publishers, printing houses and merchants as well as the packaging and the joinery and construction industry worldwide. It is a highly export-oriented company and has Europe and North America as its main sales markets. Stora Enso's global marketing and sales network has presence in all continents comprising more than 30 sales companies as well as a number of external agents and subagents.

Stora Enso operates mainly with wholly-owned subsidiaries but is also involved in collaboration with other firms both inside and outside Sweden and Finland. In fact, this company resulted from a merger between a Finnish and Swedish company. Stora Enso has been operating in Russia with a local subsidiary since 1975 and is located in Moscow. Its main objective is to facilitate sales as well as promote the company and its products on both the Russian and CIS markets. In the Russian Federation, the office works in close cooperation with two major local merchants, who in their turn sell paper products via more than 100 offices in the region.

### 8.5.1. Motives

Stora Enso decided to enter into the Russian market to draw benefit in the long-run. The Swedish company believed in the future growth of the market. The country also offered Stora Enso a good chance to spread risk under some controlled forms. The whole initiative came from Stora Enso and no government authority was involved when the decision to enter into the country was taken. A JV type of entry mode was preferred considering the competitive situation in the market where the business climate was very tough. Stora Enso therefore found it convenient to form an alliance with a local firm from the beginning. Another important reason in establishing a JV was the legal

requirement to have a local representation in a foreign investment. It was a belief of the government that joint ownership with a foreign partner would give local people access to Western technology. Furthermore Stora Enso was in need of some well-established distribution channel. This factor motivated Stora Enso to seek a local partner with a good distribution network rather than to build up everything by itself.

### ***8.5.2. Establishment of the Joint Venture***

After a long negotiation, the JV was formed between Stora Enso and a local partner, Balt Invest, in the autumn 1995. The Swedish firm acquired 51% which gave them majority control in the new company. It was a condition of Stora Enso that it would get majority ownership otherwise there would be no deal. However, the negotiation was lengthy and it took a long time to decide how the operation would be organized, managed and supervised. The JV is situated just outside the city of Leningrad. The forest department of Stora Enso was involved in the venture, the absolute purpose of which was to get access to the Russian forest in this region. As Stora Enso's business activity was based on forest, it was interested in ensuring a smooth supply of raw material of the special kind of trees in the region.

Balt Invest was a small firm within the Russian forest industry and had been in existence only a short time, but had succeeded in becoming well known quite quickly and had also earned much goodwill in the local forest industry. Two factors were decisive in selecting Balt Invest as the local partner, the first of which was its local know-how. In the absence of the local partner's financial strength, its competence weighted heavily in forming a JV. Balt Invest's access to distribution roads was another important factor. The company had special agreements and contacts with different ports. From their earlier experience Stora Enso could realize that this facility would help a lot to build up a workable transport network. The aim of both the partners were similar as they were in agreement to cut forest in Russia and then to deliver to Sweden for processing. They also agreed not to seek immediate goals but to concentrate on the long-term feasibility. Even the local authority played a certain role in selecting Balt Invest as the local counterpart.

### ***8.5.3. Resources***

As major shares were held by Stora Enso, it got major posts including the post of managing director in the JV. It gave the Swedish firm an insight over the

operation and direct authority in maintaining quality of the products. The Swedish presence was necessary to ensure efficiency and timely procurement of the timbers for export to Sweden. The local partner's main contribution was related to its local distribution network which could be exploited in transporting forestry products. In addition to share capital, the foreign firm extended financial support to the alliance whenever necessary. The local firm was a comparatively small company and had shortage of capital. However, it played an important role in helping with local recruitment and contacts.

#### ***8.5.4. Learning***

One of Stora Enso's main intentions from the JV was to gather local know-how and to learn about the distribution channels from the local partner. This knowledge was very important for the Swedish firm as it was highly motivated to stay in Russia and to gradually develop its own transport and logistics systems to efficiently handle the transport of timber. As the Swedish personnel were directly involved in the operation and had sufficient control on the management, it could gain access to the local partner's distribution network and acquire good knowledge of it. This knowledge greatly helped Stora Enso to develop the joint venture's own competence in the field. As a consequence, a part of the local partner's functions had been taken over by the joint venture. On the other hand, the local partner learned a part of modern technique and logistics system in handling transportation of goods. Further it came in contact with Western technique of management as the local partners' personnel worked together with Swedish employees working in the joint venture.

#### ***8.5.5. Performance***

From the start, Stora Enso tried to gain more control on the operation and it gradually took over a part of the local partner's functions in the JV. The Swedish partner was also considering investing more capital in acquiring further equity ownership in the company. This attitude was not liked by Balt Invest because it wanted to keep its ownership position unchanged. However, the local partner was under pressure because there was a need for fresh capital in the company to invest in roads and railway tracks in facilitating transportation of timber. It was even necessary to develop a modern transport system with own trucks and other facilities. The JV suffered losses until 1999 but the situation was slowly improving. The total sales of the company exceeded SEK 50 million. The Swedish firm obtained access to the right forest

material and was quite satisfied with the available facility of the local partner's distribution channels. However, things were complex in Russia and the system was very slow, which affected the local operation in many ways. Stora Enso was more or less aware of these inconveniences, it therefore took those into consideration when they entered into the Russian market. Although there was loss, the overall performance of the alliance was satisfactory to both the partners. They knew that it was a long-term investment and the project would be very feasible in the near future. Stora Enso personnel said that it was the company in forestry which had been most successful in Russia.

#### ***8.5.6. General Environment***

Political and economical instability in Russia were widely known. These two factors and their possible impact on the business were therefore carefully examined when a foreign firm considered entering into the Russian market. Cultural and social differences between Russia and Western countries were also wide and could be very problematic. It is necessary to plan in advance how these issues would be dealt with. Understanding of these issues is even more important when a firm agrees to collaborate with a local partner in Russia. In this regard, Stora Enso had less of a problem. It gained a lot of working experience in Russia as it had been doing business in the region for many years. However, the major problem was related to the legislation as new laws came into effect and many existing laws were changed with very short notice. Even though Stora Enso was acquainted with the local bureaucracy, it had to carefully observe the legal environment. Stora Enso had to spend a lot of time and money to supervise the legislation system. As the investment in Russia had a long-term objective, the economical growth of the country was an important issue to consider. Among the East European countries, Russia experienced minimum growth over the years and the situation was worsened by the recent drastic fall of the currency. Stora Enso was not that anxious with the economical situation as the main purpose was to cut the forest and to support the Swedish factories with timber from Russia. All communications were done in the Russian language but it was not a problem because interpreters were available.

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# **Part 3**

## **In-Depth Discussion and Conclusion**

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## Chapter 9

# Discussion and Comparison of the Cases

In this chapter, all the cases are analyzed in compliance with the theoretical framework. For the purpose of analysis, each theoretical component is discussed under three major country groupings, i.e. the fast adapters, the medium adapters and the slow adapters. The data is compared in a way that both similarities and dissimilarities can be identified, and commented on whenever necessary.

### 9.1. Motives

In studying the alliances, it is essential to consider the motives as they can explain the degree of willingness, commitment, experience, flexibility and adaptability, as well as the various types of resources engaged by the participating firms in the collaborative activities. With these issues and considerations in mind, the motives of the case firms included in this study will be analyzed. The firms are divided into three groups and each group's motives will be analyzed separately, according to the countries they operate in. The motives for forming alliances, which led to various forms of cooperation between the Swedish and ECE firms, show substantial variation, and for all the foreign firms are largely characterized and dominated by similarities. However, the motives of the other partners varied greatly due to different backgrounds and environmental conditions in different countries. Even partners from the same ECE country showed considerable differences in objectives, as they differed in their internal and external capabilities, opportunities, constraints, and to what end they collaborated.

#### 9.1.1. Fast Adapters

In the fast-adapter country group, there were eight firms, Paroc Rockwool, PLM, Bulten Tools, Ecofiber, Korsnäs, and Vattenfall in Poland; and Svedala and Getinge in Hungary. The main motives for the foreign partners had to do

with risk management (i.e. risk reduction and risk sharing), project financing, legal requirements, market development, and providing after-sales and installation services in order to satisfy customers' interests and to increase sales. Local presence and gaining a foothold in the old Eastern Block were also important motives. There were also a number of specific reasons for the foreign firms getting involved in alliances. In the case of PLM in Poland, the foreign partner sought complementary competence from local partners; in the case of Paroc, the objective was to implement a development plan. The specific motives of the foreign firms in Korsnäs and Vattenfall, both in Poland, were related to taking advantage of a favorable investment climate and cooperating with competitors. Learning the rules and regulations in the foreign country and supplying the missing knowledge and skills in ensuring operational and management efficiency were also important motives.

Some of the motives for the local firms in forming the alliances concerned personal interests, i.e. to show that someone has developed a useful collaboration with a well-established West European company. Such a relationship can be useful to an ECE company and to the country at large, as in the case of Svedala's local partner in Hungary. To produce a good product at a lower cost was another motive, on the local end, for establishing alliances. Ecofiber in Poland is a good example of this. Market development was also another motivating factor, as specially noted in the case of Getinge in Hungary. Gradual privatization also induced some of the local partners in Poland to form alliances with Western firms. In general, the motives of the foreign partners were comprehensive and well articulated, while those of the local partners were many and diffuse.

### ***9.1.2. Medium Adapters***

The medium-adapter group includes seven firms: namely, Kallefall, Arvidsson, DPC Skaffe, Partec Rockwool, and Accel SC in Lithuania; Ragn-Sells in Estonia; and Ericsson in Croatia. The foreign firms had both similar and different motives. Some of the motives common to the foreign firms were those attached to taking advantage of the low production costs, e.g. in the cases of Kallefall, Arvidsson and Accel SC in Lithuania. The cost factor was also relevant for Partec Rockwool in Lithuania, but the approach used here was different from the other three cases. All of the foreign firms in Lithuania sought to reduce production costs so that they could offer their products at a lower price than their competitors and thereby gain a competitive edge. However, in the case of Partec Rockwool, the foreign firm used the existing local facility to

reduce investment costs, in contrast to green field investment-related motives in the other three cases. In the latter case, low-cost production was achieved either by finding an efficient and competent partner (i.e. Kallefall) or by establishing production in locations where salary costs were low (i.e. Arvidsson and Accel).

Other motivating factors were: market attractiveness, market development and acquiring further market shares. The Swedish firms were interested in forming alliances to gain access to important contacts at the political, government and ministerial levels in the local markets, and to establish contacts with actors with the knowledge and experience required to handle these relationships. Further, there were other specific motives that concerned individual foreign firms. In the case of DPC Skaffe in Lithuania, there was an aspect of aid, with DPC providing the alliance with several medical instruments free of charge. Accessing a well-educated workforce and the production capacity and long time experience of local partners were specific goals for the foreign partners in Accel and Ragn-Sells. Taking advantage of the business opportunities created by the Croatian government's huge investment in building the telecommunications infrastructure in Croatia, was one of the main motives for the concerned foreign partner there.

For the local firms' part, the most common motives for establishing strategic alliances were to acquire modern technology and the skills and know-how to produce and improve the quality of their final products. The only firm with a unique motive was Kallefall's local partner in Lithuania who particularly sought to increase his income in order to be able to finance its other operations and to pay proper salaries to employees. This partner's motive was partly economical and partly social.

### ***9.1.3. Slow Adapters***

This group includes five firms: Electrolux, XYZ, Holmen and Stora in Russia; and Korsnäs in Yugoslavia. The foreign firms that belong to this group shared several motives for establishing collaboration with local partners. One of the main motives was market development for their products. While the Swedish firms in Russia concentrated on both the existing market and the potential market, in Yugoslavia, the focus was limited to expansion of the existing market. Another important motive, which concerned all five firms, was that of finding an experienced local partner capable of dealing with the local authorities and maintaining important contacts, and who had a good working knowledge of how the society functioned.

Another purpose for establishing collaborations in Russia was to fulfill legal requirements, since fully-owned foreign ventures were not allowed there. But this was only valid for Swedish firms operating in Russia. Competition was also an important motive for the formation of alliances, mainly in the cases of Holmen and Stora in Russia. In the case of Holmen, the Swedish partner collaborated with a local Russian firm in order to access quality local timber at a lower cost and gain a competitive edge in the market. In the other case, it was a matter of Stora being forced to collaborate in order to survive in the existing competition. Reduction of risk and uncertainty were also significant for Holmen and Stora in considering collaborations with the Russian partners.

No common motives for forming alliances could be identified for the local partners. The motives were rather of a diffuse character and the partners were not really clear on what they expected from the collaborations. However, gaining access to Western technology to improve production facilities and product quality was a fairly clear-cut motive for the local partners in Husqvarna and Stora, both operating in Russia. Holmen's local partner sought to find a market for its products.

#### ***9.1.4. Summary***

Out of the eight Swedish firms included in the fast-adapter group, six have established alliances in Poland and two in Hungary. The main motives of the Swedish firms in this group are risk sharing, project financing, legal requirements, market development, providing after-sales- and installation service, acquiring a local presence, and using the areas of investment as a springboard to other markets. The local partners also have some distinct motives, including access to modern technology, offering good products at a lower cost, market expansion, and gradual privatization of state-owned enterprises.

In the medium-adapter group, the main motives for Swedish firms for forming alliances were the low cost advantage, market development, and developing contacts on different levels. Experienced people who are able to handle local relationships have received special consideration in the selection of local associates. On the local partners' end, the main motives for forming alliances encompass access to modern technology, acquiring skills and know-how, increasing production and improving product quality, and increasing the rate of return.

The main motives of the Swedish firms in the slow-adapter group were market development, and acquiring an experienced local partner that knows

how to deal with the local authorities and who has the necessary contacts in society and with political and legal authorities. The local partners' main motives for forming strategic alliances were to gain access to Western technology in order to improve production volume and product quality and to create a market for their products.

## **9.2. Resources**

Exchange of resources between the partners has been important in managing the alliances satisfactorily, but all resources have not been equally important. Financial resources are not usually a scarcity in the West, but are a great source of uncertainty in ECE countries. The acuteness of capital naturally varies from country to country in the ECE depending on the level of adaptability and performance the countries have managed to achieve.

### ***9.2.1. Fast Adapters***

Eight alliances from this group have been studied, located in Poland and Hungary. Both countries have shown a promptness and strong willingness in adapting regulations to support and facilitate the exchange of resources between local and foreign firms. Among the ECE countries, Hungary in particular has gained lengthy experience of working in collaboration with foreign firms as, even in its communist era, it maintained an open and West-friendly attitude. A general tendency in the exchange was that some special resources came from foreign partners, while the local partners assumed responsibility for locally available resources. The basic understanding behind resource contribution was to acquire things that were suitable and convenient as cheaply as possible, to meet quality requirements.

The local partners were mainly responsible for supplying raw materials to the joint ventures, as these could be acquired locally, and for maintaining good contacts with the suppliers. There were, however, two exceptions to this. In the case of Getinge in Hungary, the foreign partner stood all along for the supply of raw material because it was not produced locally. Due to the liberal import policy of the Hungarian government, the flow of shipments of the final goods functioned normally. The foreign partner's contribution was to pay a part of its investment in cash to upgrade the technical capacity of the establishments. Where they bought ownership through tenders as a part of the privatization program, however, they had to make a cash payment for the whole amount. Local financing was more or less available since foreign banks operate in both

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Poland and Hungary, but the partners usually refrained from borrowing here due to high interest rates. In the case of Getinge, there was no local production, and therefore no need for raw materials.

In all eight alliances, the manpower came from local sources as there was either local production from the early days, or the technology could be transferred quickly due to the availability of qualified people. The foreign partners were involved mainly to offer on-the-job training and to extend technical and managerial support to the local technicians and on-site managers. It was also quite common for key technicians to be sent to the foreign partner's parent company to receive training and technical knowledge and to see how people worked in Sweden.

Technology, technical support, production and research & development had been largely a function of the foreign firms, but there were some exceptions. Vattenfall in Poland was not involved at all in technology transfer or in any functions related to technical matters. Here, the foreign partner's role was limited to financing as it acquired partial ownership through buying government shares in running projects. The technology used is advanced and is more or less comparable to Swedish standards. However, Vattenfall does have plans to gradually become involved in day-to-day activities, which may encompass even the technical field. In the case of Getinge, the alliance was only engaged in marketing of the foreign partner's products, though technical support was given to the local partner whenever needed. The Korsnäs alliance in Poland is a very special case because no local partners are involved there. The technology used in the joint venture is standard and both of the partners are highly experienced and have sufficient technical skills in the field. Both partners are involved in this area and offer support to the local company as per contract.

Concerning marketing in the alliances, the local partners had the main responsibility. Here, marketing included delivery, customer contacts, after-sales-service and offering guarantees. In many cases, the local partners already had contacts with the customers and maintained goodwill. Language was an important factor which required the involvement of the local people in marketing.

### **9.2.2. Medium Adapters**

The number of cases in this group was seven and is dominated by the alliances in Lithuania. Issues related to technology were a common function of the foreign firms and no general comments can be made concerning other resource

areas. The local partners did play a number of vital roles, but the foreign partners often provided the critical resources for the survival and continuation of the alliances.

Supply of input was either the task of the local partners or the foreign firms depending on its technical complexity. If the final product was to be sold in the local market, it was more likely that the local partner was engaged for the procurement of raw materials. For example, Ragn-Sells concentrated on the local market and got its entire input from local sources. If export was the purpose, however, the foreign firms needed to be involved. There are several examples of export-oriented alliances where the foreign firms exclusively took care of raw materials. The foreign firms in Arvidsson in Estonia, Ericsson in Croatia, and DPC in Lithuania offered services in procuring the material as they were supplied by foreign sources and the purpose was for export. In all of these alliances, the host countries were used for low-cost production. Some of the Ericsson products were also marketed in Croatia.

The foreign firms mainly stood for the supply of cash to the alliances as all of them were well-known in their field and were financially solvent. The local partners paid their part of the equity in kind, such as buildings, older machinery and locations. In most cases, the problem of running capital was solved by the foreign partners themselves, and borrowing from local institutions was avoided, mainly due to high and unstable interest rates. The local partners were engaged to deal with local people, who constitute the majority of employees in the alliances. The foreign firms were however directly involved in training the local people and introducing Western management culture and important management concepts. In Croatia and Estonia (Ragn-Sells) in particular, foreign personnel were permanently engaged to initiate and supervise the transition process.

The technological resources provided comprised technical skills, technical support, factory upgrading and research & development, and was a major activity of the foreign firms. However, ACCEL in Lithuania was a special case, in which even local technical experts were found to play a significant role in technical upgrading at the side of the foreign partner. These local technicians were particularly skilled in electronics as many of the employees came from a military research institute in the former Soviet Union that worked with advanced technology. The responsibility for marketing was divided between the partners depending largely on where the products were sold. The Lithuanian partners had neither the competence nor the necessary contacts with foreign buyers. As production in this region was largely motivated by cost, marketing planning and activities were integrated in the overall activities of the foreign firms.

### **9.2.3. Slow Adapters**

Three alliances in this group are involved in forestry or forest-related products. The remaining two alliances, both located in Russia, manufacture traditional products and the raw materials are mainly procured by the local companies. In the case of Stora in Russia, however, neither did manufacturing take place, nor was there any such expectation from the beginning. In this case, the joint venture acquired a large forest reserve to cut and transport the product to Western Europe, mainly to Stora's factories in Sweden for manufacturing. In the case of Korsnäs in Yugoslavia, suitable raw material was not available in the country and the foreign partner had to import this from its Swedish factories. In all of the cases, the foreign partners supplied financial resources to operate the companies. Their shareholdings, which were majority, consisted partly of cash and partly of machinery and spare parts. The local partners had no liquidity and could therefore only make up their equity in land and buildings. There was no scope of borrowing here due to the insolvency of local banks and the instability of economic conditions. If further capital was required, it had to come from the foreign investors who often had difficulty seeing the prospects of the projects. One such example is Holmen in Russia, which was not willing to invest further capital in the joint venture.

It was very important to give the responsibility of management of local human resources to the local partner. The language of operation was Russian and only the local people with local cultural understanding and skills were able to take care of this delicate area, though all of the foreign firms found it necessary to maintain day-to-day control of operations and management. Training of the local technicians and production were in the hands of the foreign firms; it was not easy to find skilled technicians who could take over the production. The local partners handled the local marketing as they had customer contacts, were familiar with the local culture and spoke the language. Although it was considered by them to be highly necessary, the foreign firms had much difficulty influencing this vital area of resources.

### **9.2.4. Summary**

The responsibility of procuring raw materials was either in the hands of the local partners or the foreign firms depending on the technical complexity of the operation. If the products were made for export, the foreign firms were usually involved in the processing of the material to ensure a higher level of quality control. Financial resources, particularly borrowing options, were very limited

in all the cases. The situation was worst, however, for the alliances in the slow adapter countries, as their performance was not good enough to motivate further investment by foreign partners. The majority of the people employed were local, but the foreign firms usually carried the responsibility for training and educating them. Many of the technicians in medium- and fast-adapting countries received regular training in Sweden. Technology, technological support and research & development was a common function of the foreign firms in the alliances irrespective of the performance level of the country. Marketing comprised both domestic sales and export. Alliances in the medium adapters were used mainly to draw cost advantage and to establish production centers for selling to the neighboring countries. When the local country had a higher population, the target was usually domestic buyers.

### **9.3. Learning**

The purpose for getting involved in alliances with foreign partners has usually been stated as being to learn from each other. But a mere willingness to learn is not enough, one must also have the *aptitude* to learn and a partner who will make it easy for the learning process to take place. Learning about the local market has been a general motive for Western firms in getting involved in alliances in the ECE.

#### ***9.3.1. Fast Adapters***

This group of countries has in general come a bit further than the rest of the ECE toward market economy and the Western world. They are trying to adopt Western business culture and to learn how to do business with Westerners. A strong willingness and continuous efforts on the part of the people to learn have resulted in increased and successful foreign investment in these countries.

The local partners were in all of the cases mainly in need of learning Western ways of marketing and increasing operational efficiency. In the case of Ecofiber in Poland in particular, the local firm was initially not aware of the economic and marketing concepts used in the West. They had difficulty understanding why marketing channels were necessary and how they would work. After several intensive meetings and regular use of the concepts in the business, the local people learned many such complicated issues that were totally unknown in communist Europe. There was a general suspicion of the Western firms, which many times made the negotiations and decision making in the alliances

difficult. As time passed, however, the partners came to know each other better and things moved rather quickly. The case of Bulten in Poland offers a good example of this. Initially the local partner did not trust the foreign firm, but this attitude gradually changed and a fruitful collaboration could be established. The local partner has developed a positive attitude to the foreign associate whom he now trusts totally.

Another important type of learning took place in connection with the transition process from the centrally planned, to market economy, i.e. the local partners were able to witness how difficult the process was and how major changes related to the transition were gradually implemented into the alliances. Local employees were able to experience Western technology and how production functioned. They learned about the service concept and procedures for dealing with it in practice. This was an unknown concept in the days of communism. However, none of the local partners were able to take over production entirely from the foreign partners, though Svedala in Hungary is an example of an alliance where the local partner succeeded in learning a great deal about production technology, Western management and skills development.

The foreign partners, on the other hand, gained local market know-how, learned things about the local culture, and became familiar with key persons who might influence business activities. In PLM in Poland, the foreign firm had to deal with a lot of local bureaucracy. In the beginning, this was difficult, but the foreign partner gradually learned how to tackle it. Initially, the local partners had little knowledge about the Western firms and their way of doing things. It was therefore an important task for the foreign firms to first identify the gaps and then minimize them to ensure efficiency in the operations. The foreign partners learned how to change the central planning attitude of the local people towards market economy. In Svedala, the learning was rather special since the foreign firm was able to successfully utilize the local partner's contacts, in part for the benefit of the joint venture, and in part for its other businesses in Hungary. In Getinge, also in Hungary, the foreign firm gained knowledge of the market mechanism, technological development, market development and relevant government policies.

### **9.3.2. Medium Adapters**

Both partners have learned from the alliances, but the areas of learning differed for obvious reasons. In general, the local partners became familiar with aspects of market economy, marketing patterns in the West, and got some idea of the

technology used in the operations. In the case of ACCEL in Lithuania, the local firm was largely benefited by branch-specific knowledge because it already had previous knowledge of a general nature. It also learned to effect long-term planning and make efficient use of resources. In Arvidsson in Estonia, special learning took place when the joint venture supplied defective products to a foreign customer. The customer was dissatisfied but the local people did not know how to solve the problem. The defective goods could be replaced but the most critical problem was the time limit. The local partner saw how the foreign partner handled the matter and took precautions against such incidences occurring in the future. There were three things they learned: to inform the customers in advance of the delay, to conduct quality controls, and to plan well in advance. At Ericsson in Croatia, the local people learned about teamwork and how to develop personal responsibility. Because of the foreign firm's liberal policy, the employees were able to adapt the Western culture in identifying and delegating responsibilities to the right person.

The main knowledge gained by foreign partners consisted of local market know-how, local culture and the work patterns of government authorities. Learning in ACCEL, Lithuania, came as a bit of a surprise to the foreign partner. The local partner possessed a high degree of technical competence and was therefore able to make a big contribution to the company's core technology. The local partner's general technical knowledge and the foreign firm's branch-specific knowledge complemented each other very well. On the other hand, things went very slowly in Kallefall's joint venture in Lithuania, where the foreign partner understood that the local people must be given time to match Western marketing demands such as maintaining supply schedules, quality controls, product guarantees, etc. This patient approach proved to be appropriate as the local partner was gradually able to learn a good deal about the necessary processes.

### ***9.3.3. Slow Adapters***

In the slow-adaper countries, the local partner's learning consisted mainly of the Western way of marketing, management, planning and gaining some idea of technology and production. In the case of Stora, there was no manufacturing and therefore no learning about the technology took place there. However, the local partner did come in contact with modern techniques and machinery used for cutting and transport of logs out of the forest. In other cases, there was manufacturing involved but the local partners had no chance to effect a complete transfer of technology to the local activities. Here, the local partners

were indeed more interested in short-term profits than in concentrating on learning for future benefits and development.

The foreign firms were largely able to grasp how the local countries functioned, the problems that arose in dealing with the government authorities, and why things did not always go as anticipated. The foreign partners came to know that many things could not be done efficiently as they were beyond their control. The situation was sometimes unstable and economic conditions did not allow the partners to solve financial problems locally. There was a general understanding that doing business in this area was difficult due to the complicated administrative setup in the countries. However, in the Stora joint venture in Russia, the foreign firm gained access to the local partner's distribution network and acquired knowledge on how it was organized and functioned. This knowledge might be very helpful in future to independently organize the transport of logs in an efficient manner.

#### **9.3.4. Summary**

In all groups, the foreign firms supplied technological knowledge and technological support to the alliances. But only in the medium- and fast-adapting countries were the local people capable of learning a good deal of technological skills, enabling them to take over the responsibility of production. The ECE firms became acquainted with Western economic and marketing concepts, with using the Western style of marketing, and to some extent with the foreign firms' business culture. On the part of the foreign partners, major areas of learning included local culture, local market know-how, local bureaucracy, and other environmental issues such as the scarcity of financial backing and the inability to maintain direct contact with local customers due to the language barrier.

### **9.4. Network**

As expected, the case studies provide support to the view that collaborations entered for specific- and well-defined purposes led to the development of networks, and that these networks are assets for the alliances as well as for the collaborating firms in other current and future operations. Network is therefore one of the variables and main components of the conceptual framework in this study. This section offers an analysis of the process of network development in the twenty cases included in the study.

#### **9.4.1. Fast Adapters**

The eight firms in the fast-adapter group were observed to develop several types of networks. One of the firms which has developed a substantial and fruitful network is Getinge in Hungary. This firm has successfully developed contacts with an influential actor with a well-organized network. Through its contacts with this actor, Getinge managed to gain access to important customers, middlemen and companies with well-functioning networks with authorities and the international market. Getinge's networks enabled its dealings with government authorities and officials to be smooth. In other words, these contacts made Getinge operations easier and comfortable in Hungary. It was easier for Getinge to obtain import licenses, and even the Ministry of Health often recommended Getinge's products to Hungarian customers. All of this success was a result of a proper matching of efforts, product quality, trust and local support, which led to the development of an appropriate network. Svedala was another Swedish firm that developed networks in Hungary in connection with its cooperation. Here, the Swedish firm even managed to develop networks in other countries such as Poland, Slovakia and the Czech Republic. The Hungarian ambassador in Sweden played an important role in Svedala's network development in Hungary.

Other firms that also succeeded in developing networks in their collaborations, though not to the same extent as those in Hungary, were Korsnäs, Ecofiber, Bulten Tools, and Paroc in Poland. However, Paroc's network was rather less developed and less well structured. It is interesting to note that the five firms, i.e. Getinge, Svedala, Korsnäs, Ecofiber and Bulten Tools, not only built networks in the respective countries where the alliances operated, but also managed to develop networks in other European markets. Further, the potential to build additional networks in the near future was also observed in some of the alliances. Ecofiber and its partner in the local Polish market developed an important contact with a local company, which they utilized in distributing the joint venture's products. This new contact proved to be of substantial importance and was already regarded as a potential candidate for intimate collaboration in case of future expansion. The remaining companies, i.e. PLM and Vattenfall in Poland did not manage to develop networks.

The local partners of Svedala and Getinge in Hungary also managed to develop networks outside Sweden as a result of the collaborations. Korsnäs' local partner in Poland also has the potential to initiate networks, with the help of Korsnäs, whenever necessary. Another interesting observation is that a buyer-seller relationship has evolved between Taurus, the local Hungarian partner and Svedala as a result of the collaboration.

#### **9.4.2. Medium Adapters**

Several and different types of networks have been developed by the Swedish firms belonging to the medium-adapter group. For this group, the local partners played a significant role in the formation and development of these networks. The networks were built not only for the purpose of coming in contact with prospective buyers, but were also intended to serve other purposes. Ragn-Sells, for example, developed valuable personal contacts with the authorities to create a favorable business environment in Estonia. These government contacts gave Ragn-Sells special status in Estonian society through recognition in the form of an award received from the country's president for its outstanding contribution to the environment. The network developed in the Estonian market was also a helpful stepping stone into the Lithuanian market. In Croatia, Ericsson also succeeded in developing a productive network with the help of the local partner. Here, several useful contacts were developed with experts in the field of telecommunications, especially those from the Faculty of Electrical Engineering and Computing at the University of Zagreb. These networks were useful in facilitating operations in the Croatian market and in creating important contacts with other markets close by. Consequently, the joint venture succeeded in exporting to the Ukraine, former Yugoslavia, Russian federation, Romania and a dozen other East European countries.

Kallefall, DPC Skaffe, Accel SC and Partec Rockwool in Lithuania, as well as Arvidsson in Estonia, also developed networks in close collaboration with their local partners. In the case of Kallefall and Arvidsson, these networks were helpful in locating and establishing links with sources of supply for the raw materials used in the alliance operation. These were industrial relationships. In the case of DPC Skaffe, the networks developed were with the authorities and public sector institutions. These government actors possessed the critical resources needed, such as funding, to make the networks function and played a significant role in allocating these resources so that decisions to purchase could be made. A major part of the alliance's customers were government organizations. The local partner, Diagnosta, played a vital role in developing these contacts with the foreign firm, DPC Skaffe.

The network established in the case of Accel SC in Lithuania was somewhat of an exception as it did not concern the alliance at all. The contacts developed here were with two local companies, i.e. Villinius SC and Banga, who became Accel's suppliers of components for the construction of solar sensors, a product used in the car industry. The network developed by Partec is also interesting in that, in addition to the alliance network, Partec also entered the local partner's network and developed contacts at the various levels of the administrative

bureaucracy and the political arena. It also developed a network of local suppliers.

#### ***9.4.3. Slow Adapters***

The slow-adapter group includes four alliances in Russia and one in Yugoslavia. Out of these, four Swedish firms were found to develop networks, whereas the fifth firm, Holmen, had no visible networks. In this case, the partners had a difference of opinion and were engaged in conflict from the very beginning. Operations did not work as expected and therefore the alliance did not earn a profit. Because the partners were not cooperating, no fruitful contacts could be developed based on the alliance.

In the cases of Husqvarna and XYZ in Russia, both firms managed to develop properly functioning networks through joint efforts with the local partners. The local partners helped in developing contacts with various governmental authorities, and the lawyers, who could deal with the complicated Russian law, customers, and other business-related relationships. Husqvarna and its local partner had to develop a joint network in Russia in order to deal with problems that cropped up in their day-to-day operations. This is a clear manifestation of the fact that it was not only difficult for foreign firms, but also for the Russian partner, to navigate the domestic Russian market. Certification and taxation were typical obstacles in Russia, and made operations complicated. Appropriate networks had to be developed in order to handle these problems. The local partner played a crucial role in managing the certification process and in negotiations with the tax authorities. XYZ and its local partner also managed to enter each other's networks which proved highly beneficial to their own development and expansion. Both partners utilized the other's networks, for the existing collaboration as well as for their individual operations.

Even Korsnäs succeeded in developing networks in the Yugoslavian market and other foreign markets such as Russia and Greece. These contacts were developed with the help of a number of influential local people, not by the local partner as we witnessed in the cases of Husqvarna and XYZ in Russia. The Korsnäs networks in Yugoslavia could not be properly utilized as the country was suffering from economic crisis. However, once the potential growth of the market is realized, the foreign firm will be in a good position to make the networks workable. Stora extended its own networks in the different areas without involving the local partner, concentrating here on centralizing to gain better control of the operation.

#### **9.4.4. Summary**

In the fast-adapter group, the role of individual actors in initiating alliances and developing networks was clearly observed in the Hungarian market. The case firms operating in Hungary and Poland have developed well-functioning networks both in the local markets and in markets outside of the area where the alliances have customers. This is a clear indication of the importance of networks in strategic alliances and demonstrates how these collaborations can be used to develop local networks, and how local networks can be used to develop international networks.

In the medium-adapter group, both parties were observed to play a significant role in developing networks. In all three of the countries, the Swedish firms were able to create well-functioning networks, which were useful to the alliances and to a number of other operations within the local markets and beyond. The Swedish firms have also managed to enter the networks of their collaborating partners.

In the slow-adapter group, the Swedish firms operating in Russia have developed networks in collaboration with their local partners. These networks were fruitful for their individual and joint operations. They have also managed to enter each other's networks with their local partners. The networks developed in the Russian market in particular were helpful in dealing with the various governmental authorities. The Swedish firm in Yugoslavia, Korsnäs, has also developed networks both in and outside that country's market.

### **9.5. Performance**

The performance of the alliances varied due to factors such as the relationship between the partners, marketing efficiency, market opportunity, customer contacts, financial situation, economic and political environment, cultural adaptation, and technical skills of the local people. If there were irregularities at the macro level, these usually affected the alliances and their performances negatively. In cases where the external environment was stable and supportive, solving problems within the alliances was relatively easy.

#### **9.5.1. Fast Adapters**

For the case firms in this group, the overall performance was good in all the cases except PLM in Poland. However, even in the PLM's case there was general satisfaction in the relationships between the partners. In this case, the

objectives were not fulfilled as the market did not develop as anticipated. The economic crisis in Russia was said to be the main reason for this setback since Russia was considered to be the main market for PLM products manufactured in Poland. All the alliances were however profit earners and had a considerable part of the market share in their core business areas. There was general agreement among the partners to continue their relationships except in the case of Svedala in Hungary. The Svedala joint venture was doing well and the partners were satisfied with their mutual performance, but the government wanted to sell out their shares as a part of the privatization program. Svedala participated in the tender but a German company, which was prepared to pay a very high price for the shares, won the bid. The German company asked Svedala to remain as a partner but Svedala opted to sell its shares and leave the alliance. Svedala and the German-owned local company have a good relationship and sell one another's products in Hungary and Western Europe.

Although PLM had problems with the export market, it preferred to continue the alliance considering the importance of Poland as a country of investment. Results for Getinge, Hungary, were extremely good and the foreign firm was willing to increase its shareholding in the current alliance. In Ecofiber, Poland, the foreign partner was willing to strengthen its market position by setting up a new factory close to major customers. The local partner preferred to expand within the existing factory facilities and to avoid further investment. In the Korsnäs joint venture, also in Poland, where both partners are foreign investors, they have decided to form a new alliance between them. The new company will be established in the Netherlands and its major area of operation will be collection of composted household and garden waste.

### ***9.5.2. Medium Adapters***

Alliances in this group were for the most part successful in attaining their objectives. This was particularly true for the foreign firms. One example, Partec, operated a joint venture in Lithuania along with a local firm and a few local financial institutions as partners. Over time, the foreign firm succeeded in acquiring local market know-how and was able to begin operating independently. After a period of two years, the foreign firm and the main local partner agreed to change the ownership structure. The local partner sold all his shares to the Swedish company in exchange for investing in his other business. The foreign firm was however given a free hand in organization issues and decisions it found suitable and necessary for the improvement of this other company. In fact, Partec was able to obtain everything that it wanted: first — local support

to acquaint itself with the local environment, and second — help over the risky period of investment and thereafter full authority to operationalize its views and ideas.

There was one case (ACCEL in Lithuania) where both partners were highly satisfied with the performance and the collaboration itself. The parties were active in the exchange of complementary resources and were able to acquire a healthy market share within a short period as they succeeded in finding a market niche. Both of these partners engaged in long-term planning, and the overall environment of the joint venture and salaries of the employees were good. Except in the case of Partec, all partners were willing to continue their alliances, though Ragn-Sells in Estonia also expressed a willingness to acquire further shares or to take over the company altogether. Estonia was a big focus for this foreign firm and it had already established a separate wholly-owned subsidiary there. This company was bigger than the joint venture and had been very successful.

### ***9.5.3. Slow Adapters***

The performance of the alliances in this group was more or less unsatisfactory. The major reasons for this were local bureaucracy and mismanagement by government authorities. At times cultural conflicts made things difficult in the alliances and partners differed markedly on the major objectives of running the operations. With the exception of Stora in Russia, the local partners demonstrated their short-term goals with the ventures whereas the foreign firms' entry into the region was characterized by long-term motives and attainment of future benefits. In the case of Korsnäs in Yugoslavia, the impact of the environment on the alliance was substantial. The political situation in Yugoslavia was highly unstable and the factory had to be closed on several occasions due to war. This led to major losses during the years of the alliance.

Most of the partners stated that their expectations in forming the alliances had not been fulfilled. But surprisingly, there was only one firm, Holmen in Russia, that wanted to leave the alliance. Holmen's situation was an extreme one. The joint venture suffered continuous losses over the years and the foreign partner could see no prospect in the joint project. Consequently, it withdrew from the collaboration through the sale of its share capital to another foreign company. The decision to withdraw was largely based on the following factors:

- (a) cost-ineffective production;
- (b) imposition of new taxes;

- (c) management conflicts;
- (d) lack of suitable timber; and
- (e) non-profitability.

#### ***9.5.4. Summary***

Performance of the alliances in the medium- and fast-adapting countries met the general objectives of the partners. In some cases, partners sold out their shares, not because of unsatisfactory results, but for other justified reasons behind the decision to withdraw. General environment has had some effect on the performance, with respect to market and lending from local financial institutions. The difficulty of financing was mainly solved by the foreign partners. Performance in alliances in slow-adapter countries was unsatisfactory due to several reasons, including local bureaucracy, political and economic instability, cultural conflicts and differences in goals. The alliances in this group also had yet to achieve profitability. Thus, in one sense, the foreign firms' investment in the slow-adapting countries were characterized by long-term planning and obstinacy. The foreign partners in general, however, believed in the alliances and wanted to continue with the relationships.

### **9.6. General Environment**

It was vividly observed in the various cases that the general environment and its sub-variables had a considerable impact on the collaborations. Therefore, this section discusses and analyzes the role of general environment, how firms handle the demands and constraints imposed by environment, and with what result.

#### ***9.6.1. Fast Adapters***

The fast-adapter countries include Poland and Hungary and the impact of these two countries' environments on the eight collaborations with the local partners studied will be dealt with here. The business tradition which previously existed in the ECE countries affected the operations of these alliances. The local partners did not have the experience of buyer-seller relationships as they exist in the ECE. Historically, purchasing, production, marketing and pricing were

centrally managed (administrated) in ECE and customers had little alternative than to buy what was available at the given price. The different backgrounds and experiences of the partners had a significant impact on the operations and the results. The companies from the West were accustomed to a market economy where things were determined through buyer-seller interaction. The local partners did not understand how market economy and management function in the West. Initially, these differences generally affected the operations negatively. In the course of time, however, the local partners managed to change many of their attitudes and adopt the market economy approach, which enabled the alliances to function properly and achieve the desired results.

Cultural differences had a significant impact on the relationships of the alliance partners and their joint operations. In all cases, with the exception of Vattenfall, there was no evidence of shouldering responsibility and working independently by the local employees. Organizational structures were centralized in the EEC countries, and it took time to convince the local partners to change their organizational structures and adapt to decentralized structures and Western management style. The Swedish firms attempted to bridge these gaps through training and employing locals with experience of working with firms from the West.

Language was also observed to be a problem in most of the cases and there was a limited number of local employees who could speak English. The Swedish firms handled the communication problems in three phases: firstly, by using translators for regular and mid-level employees, which was a short-term solution; secondly, by arranging on-site English training for middle management; and finally, by offering extensive language instruction to higher local officials as a part of long-term planning.

Financing is a critical resource in both Poland and Hungary. There were local sources of financing but the interest rates for borrowing were very high. Almost all of the Swedish firms, except Svedala in Hungary, either used their own source of capital or borrowed from international financial organizations. Svedala and its local partner used local sources of financing as they found them to be favorable. In the case of Getinge in Hungary, the foreign firm provided special credits to the local partner as they had difficulty paying. The local partner was one of the main buyers of the alliance products. Even these terms of credit were sometimes in need of further extension. Being a critical resource, financing has been used as a negotiating tool and a means of getting one's demands met. In the case of Eckofiber, the Swedfund International was asked to finance the joint venture when there was an acute shortage of financing. Swedfund agreed to finance the project provided it was offered certain

ownership and control over the alliance. This shows the criticality of the financial resource in the region.

Government regulations affected the Swedish firms collaborations' with the local partners in several ways. Five alliance operations, i.e. Getinge in Hungary, and Paroc Rockwool, Bulten Tools, Vattenfall and Ecofiber in Poland, were seriously affected by these rules and regulations. In the case of Getinge, the customers were unable to make frequent orders as they depended on allocation of government funding, which was often a restrictive and uncertain process. In the other four cases, the actions of the Polish authorities were found bureaucratic and quite unpredictable. Regulations were subject to frequent change and it was sometimes difficult to know what was coming next. In the case of Bulten Tools, export and import policies were observed to be difficult to deal with. Another problem related to the payment procedures to customs officers, who received commissions on amounts earned through them. The clearing of goods was therefore intentionally delayed so that high demurrage fees could be charged, which in fact increased the custom employee's total income. This irregularity often led to delays in production and final delivery of the products. However, Svedala in Hungary and Korsnäs in Poland experienced the authorities they dealt with as understandable, helpful and cooperative.

### ***9.6.2. Medium Adapters***

The alliances considered in this group were located in three countries, namely, Estonia, Lithuania and Croatia. Geographically and culturally, Estonia and Lithuania are closely related and belong to the Baltic States while Croatia is a part of the former Yugoslav federation. Still, there were many things that were common to the countries since they all experienced communism and state ownership in business. However, the former Yugoslavia happened to be somewhat liberal due to its practice of so called "mixed economy".

Initially, the alliances were affected by traditional socialist attitudes of the local people. The employees had difficulty understanding Western marketing concepts as they had virtually no experience of marketing products. It had previously been a seller's market where people had to buy those things that were available. All business strategies were a matter of central planning and there was almost no scope of decision making at lower levels. Confronted with the traditional views of the local people, the Westerners had to invest a lot to help the locals to begin thinking in terms of competition, quality and profitability. Whenever needed, training was given to the employees so that they could understand the mechanism of market economy. Both the Baltic

States appreciated the changes and swiftly adapted to them. But in Croatia, things went a bit more slowly as the country was involved at war with its neighbors for several years.

Language appeared to be a major problem in all of the countries since very few people were able to communicate in English. In Ragn-Sells in Estonia, the situation was different since the local Managing Director spoke Swedish fluently. All communication between the partners went through him. In other cases, people in top management were offered English courses while those at other levels learned to communicate through on-the-job training in the language. The overall situation quickly improved due to serious efforts by the local people to learn. This was particularly true for Estonia and Lithuania. Another environment-related problem was that of financing. There was a general shortage of capital among the local partners. It was also difficult to find local financing to meet the shortage of working capital. The financial markets were more or less unstable and therefore the exchange rate often fluctuated. To cover the risk, local banks charged a higher rate of interest for borrowing. As they were not willing to pay the high lending premiums, the alliances avoided borrowing locally.

### ***9.6.3. Slow Adapters***

In this section, the impact of the general environment in Russia and Yugoslavia on the five collaborations that operated in those countries will be analyzed and discussed. Here, the business tradition gap had a significant impact on the joint ventures, although this was not clearly illustrated in the cases of Holmen and Stora in Russia. One concrete example is the case of Husqvarna, where the local partner was totally uninterested in developing a distribution network for the sale of the products. It was difficult for the Swedish firm to persuade the local partner. As a result, a completely separate sales unit was established exclusively on the initiative of the foreign partner. In the case of Korsnäs in Yugoslavia, a well-functioning network was found to be more important than high quality products. In the case of XYZ in Russia, the existence of personal relationships appeared to be an important criterion for collaboration. It took a long time and resources to build up such relationships.

Cultural differences were extensive in the five cases and made it difficult for the joint ventures to function properly. In the cases of Husqvarna and XYZ in Russia, the differences mainly involved organizational matters and a lack of understanding due to the language. Here, there was no interaction among the employees and management in decision making. It was a matter of one-way

communication where the managers made the decisions. The decisions then had to be implemented as they were and no modification was permitted even if they were of benefit to the company. In both the cases, the employees remained passive and therefore unable to take innovative action that could lead to solution of problems. This had a negative impact on the operations of the joint ventures. Measures were taken but were insufficient to adapt the organizational structure to bridge the gaps. Cultural differences were in fact one of the key factors that forced the Swedish firms to collaborate.

Financing was a critical and scarce resource in both Russia and Yugoslavia. The shortage of local financing had a number of adverse effects on the alliance operations. The Swedish firms had to find ways to solve financial problems. Korsnäs made a barter arrangement to handle the financial and economic crises. The lack of local financial sources was less significant in the case of Stora in Russia, as the alliance was mainly engaged in cutting and exporting timber from Russia.

All of the joint ventures in this group were severely affected by the government rules and practices in Russia and Yugoslavia. The four firms operating in Russia had similar experiences. The rules and regulations were perceived as difficult to understand and could be interpreted in several ways. Not only that, but general rules and regulations, and customs and taxation policies changed frequently, making planning and managing operations difficult. Moreover, production as well as import and export taxes were very high and thus made the operations expensive and the products less competitive. The foreign firms were forced to expend too many resources in minor details, less significant for creating value for the customer. There was much bureaucracy in the systems and matters often had to pass through several authorities whose focus on these minor issues delayed the process. Corruption was another obstacle for the alliances. There was a risk that if the concerned authorities were not given bribes, the processing of documents could be unnecessarily delayed or even lost. Here, connections with the decision makers were more important than following the correct procedures and fulfilling requirements. The Swedish firms had some difficulty adapting to the local praxis as they concentrated on the official procedures rather than opting to do things through corrupt means.

#### ***9.6.4. Summary***

The environmental factors that affected the alliance operations in the ECE largely include cultural differences, shortage of language skills, government

regulations and bureaucracy, lack of financial resources, and traditional and communist ways of thinking. In actual fact, the foreign firms were confronted with two type of culture in ECE alliances: national and socialist. The ways of handling these cultures was different in different cases, depending for the most part on which countries the joint companies operated in. As expected, the fast-adapting countries offered the most alliance-friendly environments in the ECE. These countries were already aware of the practices of foreign firms, and many local employees had the opportunity to gain work experience from the foreign personnel. The cultural gap in the alliances could be quickly minimized, partly due to the open attitude of the people, and partly to the possibility of hiring experienced local people. As a whole, the fast-adapting countries have taken various pragmatic steps towards privatization and market economy. The pattern of change in the medium-adapter countries is following that of the fast-adapter group but still lags behind on many aspects. For both of these groups, financing was still an open threat for working capital and expansion programs, though the situation was not identical in the two groups. In the fast-adapting countries, there were international financial companies operating and also willing to lend money but the alliances could not afford to borrow due high interest rates. In medium-adapting countries, the financial market was not yet developed, and even where money was available, the rate of interest was exceptionally high.

The situation in the slow-adapting countries was completely different from the other two groups of countries. Although these countries to a large degree shared the same starting point, this group showed no real indication of accommodating changes in the fields of operations and management. Cultural differences remained high and partners in the alliances experienced a wide gap due to communication problems. The local mentality remained unchanged and people lacked knowledge on how market economy works and how Westerners view business. Although the local governments, particularly in Russia, professed to have an open attitude toward foreign direct investment, no satisfactory results occurred at the operational level. Frequent changes in laws and tax regulations did not make the outlook any brighter for foreign firms. A further problem was financing, as there was a lack of professional lenders in these countries. Because of the high risk, the rate of interest charged on any financing that was available was totally unacceptable.

## Chapter 10

# Research Findings and the Literature

This chapter is devoted to identifying and discussing the main issues of the research findings in relation to relevant studies in the field. The purpose has been to focus on whether the result corresponds to the present body of the literature or not, and what new thoughts and ideas can be generated by the matching of literature and outcomes of the underlying study.

### 10.1. Common and Individual Motives

Motives have been dealt with in this study in two steps. First, the countries were divided into different groups based on the countries level of political, social and economical development, and their success in adopting market economy and privatization. Second, the motives of both of the partners in an alliance were taken into account. The assumption has been that all ECE countries firms do not share the same reasons for entering into alliances, and nor do the foreign partners consider these countries completely identical. Many studies on alliances have focused on motives, and some of them specifically address East-West relationships, but none have applied country classification as a key tool in examining motives. This study has shown that such an approach is helpful in attaining a deeper understanding of motives in ECE alliances and in pursuing only those motives that are reasonable and attainable from both partners' viewpoint. In this section, the major motives found in the study are taken up and related to the relevant literature. This is done at two levels: regional (i.e. ECE) and country group (see Tables 10.1 and 10.2).

Market opportunities in the ECE have been a recognized factor for foreign companies considering investment in the region. Many companies have taken these opportunities seriously and quickly entered the region to cash in on the first mover advantage. The key parameters surrounding strategic alliances are opportunism, necessity and speed (Newman & Chaharbaghi 1996). Nigh *et al.* (1990) reports that immediately after the refinement of legislation permitting

Table 10.1: Common motives of alliance partners.

<b>Category</b>	<b>Common Motives</b>	<b>Literature</b>	<b>Comments</b>
Foreign partner:	1. Market development	1. Culpan & Kumer (1994); Fahy et al. (1998)	1. Market-seeking concerns both actual & potential markets.
	2. Local contacts	2. Geib & Pfaff (2000); de Kort (1999)	2. Very important from cultural viewpoint.
Local partner:	1. Access to modern technology 2. Quality products	1. Geib & Pfaff (2000); Osland & Yaprak (1994)	1. Highly attractive for Western partners' cutting-edge technologies.

foreign participation in the Soviet Union in the late 1980s, more than a thousand foreign firms formed equity joint ventures with Soviet partners. The opening of the large non-exploited ECE market has been considered by many firms as a rescue when the developed country market became highly competitive. Another related issue in establishing local contacts through alliances, is already treated in the literature. From a historical standpoint, the ECE differs from the Western world on many issues. When entering an ECE market, Western firms are therefore eager to develop relationships with local people who can deal with social, political and cultural differences. This study strongly supports Geib & Pfaff's (2000) argument that the most important need fulfilled by strategic alliances in the ECE is perhaps the provision of expertise by the foreign partner and familiarity with the market environment by the host country partner. Depending on the extent to which the cultures of the partners differ, the alliance work may prove difficult (Walters *et al.* 1994).

The situation in the ECE is in many ways comparable to that in the developing countries. Many studies on the developing economies (Beamish 1984; Abraha & Hyder 1997; Tatoglu & Glaister 1998; Hyder & Ghauri 2000) have recognized that local partners enter into alliances with foreign firms to come in contact with Western technology. Alliances are an appropriate form to become acquainted with foreign technology as the foreign technicians are directly engaged in the day-to-day operations. It is well known that the technological gap between developed and developing economies is wide. This study offers evidence that ECE partners seek foreign technology to offer better products to increase competitiveness and profitability. The issue of quality is directly related to better technology, meaning it is both conceivable and reasonable to view these two factors as local partners' motives.

The individual motives of the foreign and local partners in each country group are presented in Table 10.2. As the ECE is fairly unknown to the foreign partners, and the political and economic conditions uncertain, foreign firms in the fast-adapter group preferred to share the risks with local associates. In the literature, it has long been argued that unfamiliar environments (for example, developing countries or the ECE) require that local interest groups be linked to operations to reduce risk. In a fairly recent study, Barney (1996) suggests the inclusion of important parties in the alliance ownership to avoid cheating and to increase the partners' interest in the project. Alliances involve shared risk, which requires mutual adjustments that cannot be specified in advance (Lewis 1990). Acquiring a local identity through alliance is considered important by foreign partners in order to gain the legitimacy required to mobilize local resources and to gain national status. This is a critical factor in the ECE region as the local people's experience of Westerners is relatively new and there is still

Table 10.2: Individual motives of alliance partners.

<b>Category</b>	<b>Group</b>	<b>Motives</b>	<b>Literature</b>
Foreign partner:	Fast adapter	1. Risk sharing and risk reduction 2. Local identity 3. Low cost advantage	1. Brouthers <i>et al.</i> (1998); 2. Barney (1997) 3. Brouthers <i>et al.</i> (1998)
	Medium adapter	1. Low cost advantage	1. Brouthers <i>et al.</i> (1998)
	Slow adapter	1. Good local partners	1. Walters <i>et al.</i> (1994)
Local partner:	Fast adapter	1. Privatization	1. Estrin & Meyer (1998)
	Medium adapter	1. Skills development	1. Hyder (1999); Barney (1997)
	Slow adapter	1. Highly diffuse motives	1. Goldman (1999)

some confusion about the market economy among the older generation. Barney (1996) argues that alliances can be even more important when government regulations favor local firms over firms from other countries. In fact, many governments, even in the industrialized countries, consciously patronize local firms in different ways (see Malhotra 1999).

Low cost advantage has been a motive of the foreign firms for entering alliances in both the medium- and fast-adapting countries. Kogut (1988) finds cost of entry into new markets to be an important motive for considering alliance formation with a local partner. This cost may include the cost for local knowledge, local distribution networks and local political influences (Barney 1996). However, the cost motivation associated with alliance formation in the ECE concerns mainly human resources and local raw materials. A foreign firm will be attracted by these lower costs when products are to be exported and cost advantage is a major requirement. Finding a good local partner has been a clear-cut motive of the foreign firms for forming alliances in slow adapting countries. This is understandable since the countries in this group have in recent years shown high political and economic instability. Things can change quickly and new regulations affecting business activity come and go. Further, there are complaints of many irregularities at different levels of government. In the case of Russia, although the country offers vast opportunities to foreign firms, it is also said to be a highly difficult and uncertain market in the region. As Goldman (1999) points out, having defaulted on its debt (the Russian government), the banks became insolvent and the stock market crashed. A firm considering entering the country, must in such a situation give first priority to selecting the right partner, someone who can handle the local situation and who can also be trusted. Ernst & Bleeke (1993) argue that the development of trusting relationships between alliance partners is both difficult and essential to the success of strategic alliances.

Interestingly, local partners in the fast adapting countries, including Hungary and Poland, cite privatization as a motivating factor in getting involved in alliances with foreign firms. The governments in these countries are committed to privatizing major industries to achieve industrial growth and efficiency. This privatization has opened the scope of collaboration with foreign firms since they often assume joint ownership of the previously government-owned companies through the purchase of shares. Goldman (1999) argues that privatization in Poland was delayed by a few years compared to Russia. This unintentional delay was helpful for Poland in at least two ways: Poland was able to learn from Russia's mistakes, and the local people were able to gain knowledge and experience of Western business practices in the meantime. In the medium-adapting countries, skills development has been an individual

motive for the local partners involved. The partners from Baltic States have shown an interest in becoming closely acquainted with the foreign partner's technology and have tried to play a complementary role in the alliances. Their historical ties with the Nordic countries have made it easier here for the local people to accept Western business culture and to operate in a more professional manner. No particular motive for the local partners in the slow-adapting countries is observed as the local people are much less clear about what they expect from an alliance except the financial returns.

## **10.2. Exchange of Resources: Expected and Actual Contribution**

A central variable of the theoretical framework discussed in the study is *resource*. This section addresses this variable on two levels: general and country group. We begin with a general discussion. The contributions made by the partners have been important all along in supporting the activities of the alliances. A number of researchers, such as Sharma (1983), Hyder (1988), Eisenhardt & Schoonhoven (1996), and Rangone (1999) have dealt with resources in their empirical works. The latter two have used a resource-based approach as the starting point, while the first two works are based on a resource-dependence perspective, mainly developed by Pfeffer & Salancik (1978). Hyder's work is more elaborate and systematic as he uses an analytical tool to compare a partner's resource expectation with its contribution, i.e. that initially committed and that ultimately extended. Based on the extent of this difference between expected and actual contribution, Hyder tries to determine a partner's ongoing interest in the collaboration. The current study does not provide the scope to measure such differentiation in resource contributions, but the idea developed in the current study can be helpful in understanding why some alliances work and others don't.

In general, the foreign partners in the study have been responsible for technology, technical support and research & development. In fact, the foreign partner's capacity to solve technical problems has been one of the main reasons for their participation in the alliances. It is perceived that the foreign firm's technological knowledge will complement the domestic partner's local market know-how and local contacts. Another area where the foreign firm's contribution is considered a given is in foreign capital. In most businesses in most Central and East European countries, there has been a chronic shortage of working capital (Clothier 1997). On the other hand, it has been expected that

the local partner's contribution would include local support in the form of government contacts, local distribution network, familiarity with the local culture, etc., as well as playing a major role in local recruitment.

Turning the discussion now to focus on resource contributions at the country group level, in the fast-adapting category, specific contributions by foreign firms consist of training of the local people (both in ECE and in Sweden), supply of raw materials (due to non-availability in the local market), and contacting buyers (in the case of export). In addition to technical support, the foreign firm's contribution in the medium-adapting countries includes cash arrangements, training, and sometimes offering relatively permanent services by foreign personnel in the alliances. In the slow-adapter group, the foreign firms have been engaged in offering on-the-job training and financial support to the alliances. However, the future of the alliances in this region has become uncertain due to political and economical instability. This has also made foreign firms reluctant to make further investment in the alliances. Further, confidence in the local associates has not been the greatest, which has rendered foreign firms less willing to give the local operations priority. In a recent study, Goldman (1999) shows that this situation in Russia has been enough to keep foreign investors away from the country.

The contribution of local partners in the fast-adapting countries has been substantial with respect to locally marketing of products. The foreign firms lack the required contacts and are much less in tune with the local culture. Further, this region has succeeded in adapting a lot to Western business practices and gained experience in working efficiently. The local partners are in a position to combine Western professionalism and local know-how to serve local customers more efficiently. Even the local partners in the medium-adapting countries have played a significant role in local marketing. Here, there is evidence that local firms are able to contribute equally alongside of their foreign partners in product development. But this has been a unique case. In the slow-adapting countries, as expected, no special contribution is made by the local partners. To sum up, there is a good match between resource expectations and contributions by foreign and local partners in the medium- and fast-adapting countries. In other words, the gap between expected and actual contribution is small in these two groups. In a comparison between these two country groups, it is likely that the least gap occurs in the fast-adapting countries. In the third category, the slow adapters, none of the partners come close to fulfilling the expectations as things have deteriorated over time and there is no productive communication or understanding in the alliances. The relationship between expected and actual contribution in the three groups of countries is presented in Figure 10.1. The political and economic environment is more stable in the fast-adapting

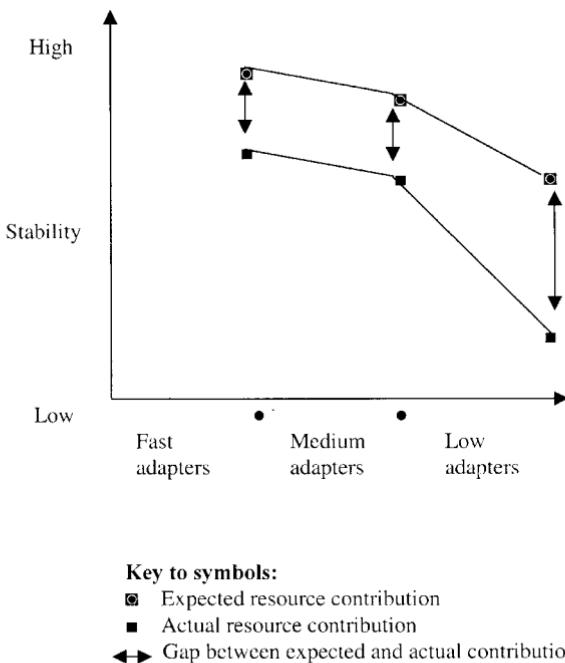


Figure 10.1: Expected and actual resource contribution in fast-, medium- and slow-adapting countries.

countries and therefore matching in the expectations and contributions in this region, from both partners, are strong.

### 10.3. Learning and Network Development

In the literature, learning has been described as an important factor for the alliance partners (Varadarajan & Cunningham 1995; Tsang 1998; Hyder 1999). The cases in this study show that foreign and local partners have different things to learn, but that the learning intentions of all of the foreign associates are the same. Irrespective of host country, the local partners maintained almost similar learning objectives. These partners were interested in learning about the foreign technology and technology-related matters, and the mechanism the Western markets function. As expected, major learning took place in the medium- and fast-adapting countries. This is understandable considering the local partners have a more or less clear conception of the skills and

technological knowledge they must learn to make technology transfer possible. The situation in the slow-adapting countries, on the other hand, was different due to a lower level of technical skills on the part of the local associates. Further, a true willingness to learn was missing, as short-term goals dominated the local partners. This observation corresponds well with Hamel *et al.* (1989) who argue that success in learning depends on three factors, i.e. the intention, openness and ability of the partners to learn. To differing degrees, all of these factors were present in the medium- and fast-adapter country alliances.

The learning that takes place in alliances between Western and ECE countries is asymmetrical (Tsang 1999). There is a large gap between the partners with respect to technical skills and managerial competence. Though not stated explicitly, Tsang views learning as something one-sided that takes place in alliances between Western and ECE countries. The observation in the current study, however, demonstrates that this learning can occur in both directions. Using this point of view, the learning of the foreign partners has been comprised of local know-how, local culture and ways of communicating with key people. Again, success in this type of learning has been dependent on the stability, maturity and growth of the host countries. In the fast-adapting countries the foreign partners learned quickly and were therefore able to effect fast expansion into other fields. Because their learning was so efficient, these firms could also begin to think about developing other joint projects aside from the existing collaboration. In the slow-adapting countries, the foreign partners' learning was interrupted due to unstable political and economic situations.

Like learning, network is an important variable in our theoretical framework. Because they are closely related to learning, some network issues are taken up here. When the foreign firms entered the region, they did so with the purpose of creating a number of relationships there to ensure that their joint operations would function. Different ties had to be made with various parties, including policy makers and government officials, suppliers, local buyers, potential buyers from neighboring countries, distributors, and the local partners' associates. A general observation has been, is that when important contacts could be established, and these relationships functioned properly, other activities in the alliances also did well. Johanson & Mattsson (1987) have correctly pointed out that relationships with other firms constitute an important investment. This is particularly important when operating in unfamiliar countries where conditions are different. We have found that not only other firms but also government agencies are vital factors in joint operations in the ECE. This has also been clearly demonstrated by Abraha (1994) who has studied establishment of foreign firms in Africa focusing on a network perspective.

Medium- and fast-adapting countries offer us examples of building successful networks with different local parties of interest. Network formation has also been a clear motive in the alliances operating in slow-adapting countries. The success in the case of the latter, however, is mixed due to unstable political and economic situations in these countries. In particular, relationships here with the major customers have been adversely affected. The alliance's country location has also had an impact on the nature and selection of parties with whom to interact. In the fast-adapting countries, the need for government support and involvement was minimal, which freed up many of the foreign firm's resources for employment in other important areas. In these regions, efforts were made to create links with local suppliers, different distributors, customers from neighboring countries, and prominent business personalities. These latter contacts have been beneficial for the foreign partners mainly when considering the possibilities of expanding to nearby countries or into other related fields. Contacts in alliances in the medium-adapting countries have concentrated mainly on running the operations smoothly, and a search for other possibilities within a limited range. The formation of networks in the slow-adapting countries has been based purely on seeking success through local contacts with government officials and other influential people. It is difficult to relate this part of the findings to the literature, as no study has applied a country classification such as ours. However, Gulati *et al.*'s (1997) argument does make some sense here, that not all networks provide equal benefits to their members, and that some networks are better than others. This is what we have tried to point out, i.e. that partners seek different networks under varied environmental conditions.

#### **10.4. Performance and Environmental Factors**

Measuring the performance of alliances has been a difficult task since at least two partners with variety of objectives to be fulfilled are involved in the process (see Tatoglu & Glaister 1998). For reasons of convenience, researchers usually look at alliance survival as a common criterion for performance measurement. Most of the alliances in our study survived, or in some cases expanded their operation. In the medium- and fast-adapting countries where the partners were able to minimize gaps and receive unreserved support from the host governments, the success was great. In those alliances, there was a strong desire on the part of the local country for the alliances to survive and foster further foreign investment. In the slow-adapting countries, attempts to keep the alliances functioning were more or less desperate. Financial returns were not

good and most of the objectives of the partners remained unfulfilled. In at least one case, the foreign partner left the alliance due to continuous losses in the venture. Although the partners kept the alliances going in other cases, it did not mean that the results of these cases were satisfactory. The reasons for their continuation, particularly on the part of the foreign partners, were either that they had no way out, or that they believed the situation would improve in the long run.

Gulati (1998) finds two problems with survival in the measurement context. First, an alliance can face termination by way of natural or untimely death, and since natural death is accepted by the partners, it is not a failure. Second, an alliance may simply be a transitional arrangement that the parent firms plan to terminate after fulfillment of the objectives. We have examples of this in our study. In one case, the alliance was terminated upon mutual agreement and said to fulfill both partners' interests. The foreign partner took over the shares of the local partner as a part of its future plans regarding expansion in the country. The local associate, on the other hand, earned a good amount of money to invest in his other profitable businesses. Serapio Jr. & Cascio (1996) also find in their study of end-games in international alliances that a partner may need to exit an alliance because of financial difficulties or to take advantage of financial opportunities.

Performance can also be asymmetric, as we have seen that learning can be. It can happen that one firm achieves its objectives while the other fails to do so (Gulati 1998). Hamel *et al.* (1989) have earlier shown that firms benefit differently depending on the intentions and learning capacity of the partners. In this study, both partners tried to learn, at least in the fast- and medium-adapting countries. In the slow-adapting countries, the local partners seemed to associate their performance with the achievement of short-term gains from the alliances. Here, they were simply not interested in learning. And the results of this are obvious. Neither profit nor any long-term benefit could be generated.

Another important performance criterion in alliances is relationship development. The extent of financial gain is not always as crucial as how the partners have succeeded minimizing the gaps and creating a social bond between them. In such situations, partners believe in long-term goals and therefore invest in the development of mutual understanding and close relationships. To network researchers (Johanson & Mattsson 1988; Håkansson & Snehota 1990), performance is usually viewed as the ability to maintain ties with different parties to interact. However, the development of ties and their intensity should be selective on the basis of resource accumulation and its importance to the firms. In this study, relationship development was least successful in the slow-adapting countries, due to the lack of integration, social

contacts and long-term objectives. Partners in the medium-adapting countries made the best contacts because of historical relationships (between the Nordic countries and the Baltic States), and an interest in pursuing the continuity of these relationships. The performance associated to building relationships was also good in the fast-adapting countries, but was based less on emotion than on pragmatic reasons, as suggested in the literature.

If an alliance takes a firm to an industry or country other than its own, the firm has to familiarize itself with the new environment (Tsang 1999). This familiarization is essential for good performance and the success of an alliance. If the country of investment is foreign, as in our case, the environmental factors are likely to hinder operations. The list of issues requiring careful consideration is long, and includes: government regulations; political, social and economic conditions; distribution; *marketing patterns*; and connections with customers and suppliers. It is not enough that internal management and operation are in order, firms need to seek external resources, e.g. customers, suppliers, financing, local support, etc., to become successful. Financing was a general problem in the ECE and affected the alliance performance in all of the cases. It was necessary to find alternative solutions to this problem. The situation was worst in the slow-adapting countries as the foreign partners were unable or unwilling to expend further financial resources in some alliances. Other environmental problems in this region included cultural differences, political and economic instability, frequent change of government regulations, high taxes, lack of proper infrastructure, and bureaucracy. The rate of change in the slow-adapting countries was insufficient to bring about positive results in the joint activities. In the medium- and fast-adapting countries, the business environment underwent substantial improvement. Tietz (1994) has also observed significant differences in the reform policies adopted by the various countries in the ECE.

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## Chapter 11

# Conclusions and Implications

The final chapter begins with a discussion of research issues presented in previous chapters and attempts to relate our study with the theoretical rationales of alliances presented in Chapter 2. Considerations regarding acceptance or rejection of some of these theories have been neither within the scope of this study, nor consistent with its purpose; on the contrary, our aim has been indicating where more support of this empirical study is found (or not found) in the theory expounded. This effort can help us recognize circumstances where the theories are most appropriately applied, particularly regarding the study of alliances in ECE and other comparable environments. A thorough discourse on the theoretical framework is presented in order to observe its suitability in the context of our studies, and perspectives from which this framework has been largely satisfactory — including some extensions to it — are suggested. We discuss the future prospects of alliances in the region based on experiences garnered from the study, and other literature in the field. Finally, the last two sections discuss future research issues and various implications to managers.

## 11.1. Research Problems

A discussion of particular issues is essential to elucidating the foci of research work, and what results are intended to be substantially contributed. We comment here on five research problems, divided under three major headings that consider contexts of the nature and interconnectedness of the various issues.

### 11.1.1. Motives

Countries within ECE have engaged adaptation at different rates, which lends to a loose grouping of fast-, medium- and slow-adapting groups, the primary influencing factors of the divisions being:

- (1) the progress of the economy's shift from planned to market structures;
- (2) variation of market and socioeconomic structures;
- (3) particular political situations; and
- (4) economic growth rates.

Partner countries in these different groups have had markedly different motives, a consequence of differing circumstances. Firms operating in fast-adapting countries worked with largely specific goals, as the partners had very clear motivations for (and expectations from) the alliances they formed. This understanding helped partners to organize their operations efficiently, so that their mutual interests could be most effectively realized. Other factors — such as the adoption of the market economy, the presence of improved financial, legal, social, political and economic atmospheres, the open attitude of the governments, and the liberalization of markets — also significantly influenced strategies for reaching goals. Firms in the fast-adapting group generally met expectations at a higher level (Figure 11.1). In some instances realization of goals was restricted to the medium level, but firms usually enjoyed environments conducive to high-level realization in these countries.

In the case of medium-adapting countries, the degree of realization by firms was sometimes high, but with a concentration at the medium level. Similarly,

<i>FIRMS OPERATING IN</i>	<i>REALIZATION OF MOTIVES</i>		
	<i>Low</i>	<i>Medium</i>	<i>High</i>
Fast-adapting countries		XXX → XXXXX	
Medium-adapting countries		YYYYY ← → YYY	
Slow-adapting countries	ZZZZZ ← ZZZ		

#### **Explanations:**

- XXXXX = Occurring frequently
- XXX = Occurring sometimes
- YYYYY = Occurring frequently
- YYY = Occurring sometimes
- ZZZZZ = Occurring frequently
- ZZZ = Occurring sometimes

Figure 11.1: Realization of motives by firms operating in the three country groups.

firms operating in slow-adapting countries mainly achieved motives at a lower level, with limited exceptions at the medium level. Firms experienced some success, but rates of such varied directly with their respective country's adaptation level (i.e. high for firms in the fast adapters, while mostly low in slow adapters). In the latter case, the goals of the partners were often diffuse; furthermore, different environmental hindrances — such as an inability to adopt the market economy, the absence of favorable financial, legal, social, political and economic atmospheres, and restrictive attitude of the local authorities and populace — made achieving goals more difficult.

The degree of motive realization by firms often had a natural influence on the variation of those motives themselves. For example, if the degree of realization is high, partners were satisfied with the performance of an alliance and have had only infrequent tendencies to alter their goals. Therefore, for firms operating in fast-adapting countries, the revision of motives occurred slowly because the high degree of realization served as an indication that they characterized realistic expectations (Figure 11.2). Similarly, medium-level variation has also occasionally occurred; firms in medium-adapting countries mainly experienced a moderate change of motives, and to some extent a low

<b>FIRMS OPERATING IN</b>	<b>VARIATION OF MOTIVES</b>		
	<b>Low</b>	<b>Medium</b>	<b>High</b>
<b>Fast-adapting countries</b>	XXXXX ← XXX		
<b>Medium-adapting countries</b>	YYY ← → YYY		
<b>Slow-adapting countries</b>		ZZZ → ZZZZZ	

#### **Explanations:**

XXXXX = Occurring frequently

XXX = Occurring sometimes

YYYYY = Occurring frequently

YYY = Occurring sometimes

ZZZZZ = Occurring frequently

ZZZ = Occurring sometimes

Figure 11.2: Variations of motives by firms operating in the three country groups.

degree of variation. Contrastingly, rates of variation were principally high in the cases of slow-adapting countries. Alliance collaborators were not always certain that their motives were justified, and the paucity of original ideas among partners begot confusion regarding uniform aspiration and purpose. The dominant inclination was toward abrupt revision of expectations that went uniformly unmet; however, there were also outlying instances where these changes were rather moderate given the uncertain circumstances.

### **11.1.2. Resource Factors**

The exchange of resources has been one of the central issues in the study. Partners must contribute different resources to make the alliances function in a way consistent with outlined objectives. In this study, we have found that it is useful to describe resource bundles based on the degree by which their constituents complement one another. “Complementarity” occurs when the partners possess and are able to contribute — different resources and aspects of competence needed to sustain alliances. Accordingly, “non-complementarity” occurs when available resources are similar among the alliance partners. As a rule, complementary resources generally create opportunities to function well, while non-complementary resources pose constraints on the operation and management of the alliances.

With a few minor exceptions, our study has examined primarily alliances that were observed to possess complementary resources and competences. In the cases where complementarity has prevailed, the results achieved by the alliances were usually satisfactory; however, in the cases where resources and competencies were non-complementary, results were far below expectations. Indeed, in alliances of the latter case, the firms concerned were induced to take appropriate actions in reorganization of resources and competencies into arrangements that were more complementary in nature. In either case, performances that were satisfactory or below expectations induced learning experiences, which could have a direct impact on the way resources should be mobilized, contributed, and coordinated. In cases of complementarity, the alliances were observed to continue functioning in more or less the same way as initially, but in cases of non-complementary resources (and below expectation results), the partners learned that they had to mobilize resources and competencies to complement one other in order to be able to achieve their motives. The relationship between resources, learning, and performance is presented in Figure 11.3. Newly mobilized resources, adjusted to be complementary in nature, gradually became consistent resources within the

alliances' functional infrastructure, and partners then needed to learn how a continuous supply (of old, as well as recently acquired resources) could be maintained.

Resource and competence mobilization are not carried out separately by the partners concerned; this must be done in collaboration with the other members of the network, which are engaged in continuous exchange. Those alliances which could mobilize and develop competencies after a poor performance were

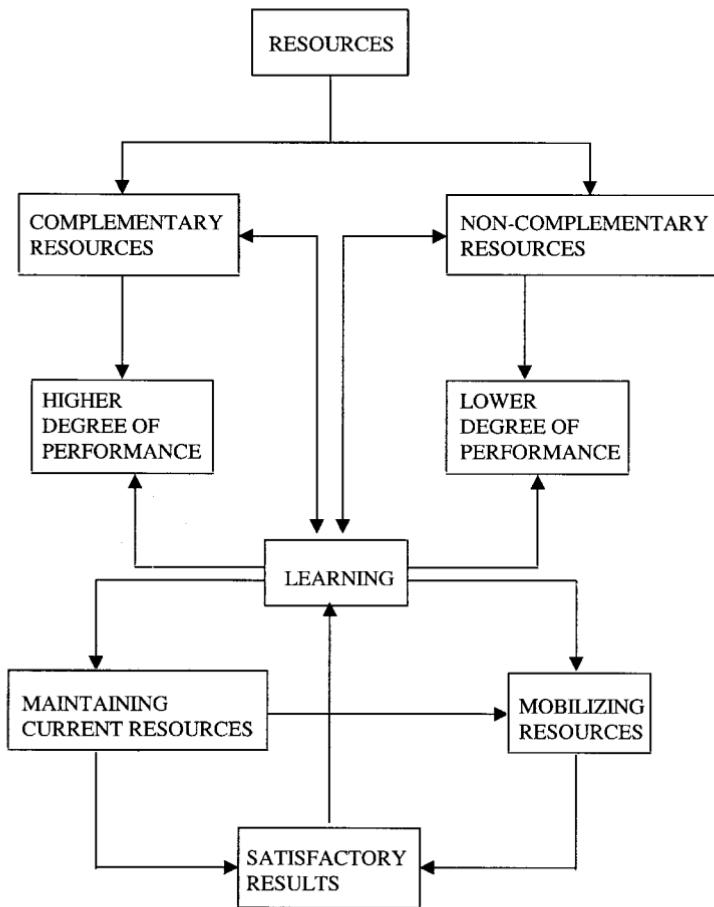


Figure 11.3: A procedural view of interaction between resources, learning and performance.

able to execute better and to meet expectations. However, those alliance partners not prepared to make further investments in development either withdrew from the collaboration, or continued to suffer economic crises. There were also firms which tried but failed to acquire complementary resources, and therefore had to either close down, or continue to operate at a loss with expectations that circumstances would improve in the future.

Another interesting finding of the study was the relationship between networks and complementarities of resources, and how differences in these criteria could lead to different levels of performance. The degree of resource complementarity can either be low or high, and networks can also be weak or strong depending on the number and types of relationships. Figure 11.4 offers four scenarios of possible combinations under these stipulations:

**Scenario I:** In the case of low complementarity of resources and weak networks, poor performance is certain to result. Necessary resources are not available for the fulfillment of goals, and the lack of network relationships also minimizes opportunities to identify and set up proper supply sources.

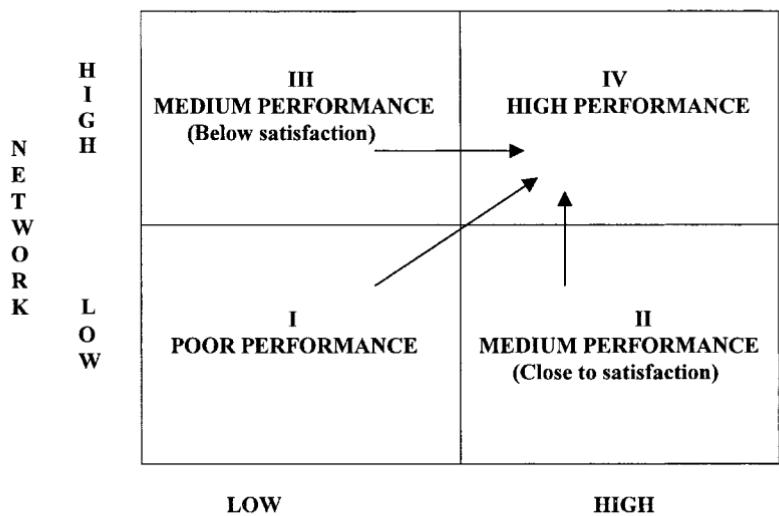


Figure 11.4: Networks, complementarity of resources, and performance.

**Scenario II:** Medium performance, which is close to satisfaction, occurs when the degree of complementarities is high and network relationships are weak. This type of situation is rare since the absence of effective networks renders contact with necessary sources difficult to establish.

**Scenario III:** This situation, characterized by the combination of low-level resource complementarity and a strong network, produces medium performance that is generally below satisfaction. However, this weakness is easier to alleviate since a strong network helps partners to find the right sources of supply to complement their resource needs.

**Scenario IV:** High performance occurs when complementarity of resources is high and network relationships are strong.

Naturally, the general tendency of scenarios I-III is to reach maximal performance, i.e. scenario IV, and to affect this development, the concerned firms were observed to strive for achieving high complementarity in their resources and strengthening their network relationships. However, in most cases, it is first essential to be a member of a strong network; this assists in both identifying and establishing links with the sources that can best provide the resources needed.

### **11.1.3. Environmental Factors**

We have found that the impact of the environment on the different firms operating in the three country groups was also of a varied nature. Additionally, the impact was different among the various stages through which the alliances progressed in ECE. The relationship between the level of impact and the process stages — e.g. introductory, developmental and operational — in the country groups is exhibited in Figure 11.5. Initially, the environmental impact was high for all of the collaborations, but this changed over time depending on the country groups in which they were operating. The impact on firms in slow-adapting countries was uniformly high, with minor variations when the initiatives taken were fruitless and ineffective. Tenuous political, social and economic situations were constant liabilities, making alliance operations risky and difficult. In the case of medium-adapters, the impact was largely mitigated over time as alliances passed through the different stages. The least impact was observed among the alliances in fast-adapting countries in both the development and operational stages, indicative of the region's flexibility towards alliances. Some of these countries — such as Hungary, and to some extent,

## IMPACT OF THE ENVIRONMENT

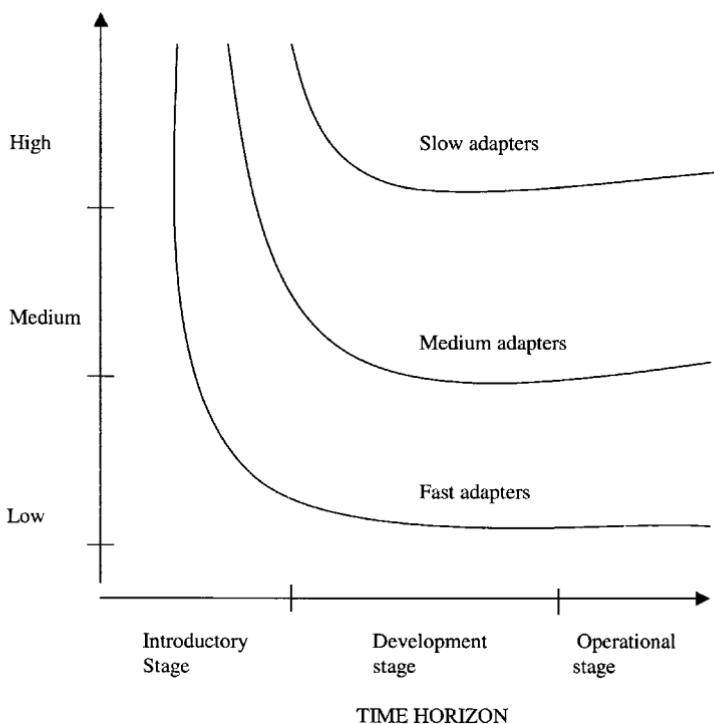


Figure 11.5: Impact of environment on the alliances operating in the different country groups.

Poland — have had the difficulties attendant to adjustment of environmental hostilities mitigated by an historically tolerant attitude toward Westerners.

As expected, general environmental factors had a great impact on the operation, as well as performance, of alliances. The relevant factors are the economic situation and market structure, governmental regulations and the political paradigm, and the social and cultural contexts; however, the role of these factors had inconsistent effects when the constraints and opportunities prevailing in the three country-groups changed. The situations in these countries had initially been similar, but changes subsequently occurred due to foreign firms' adaptations, and the local partners' changing attitude toward adoption of nescient market economies (see Figure 11.6). The highest

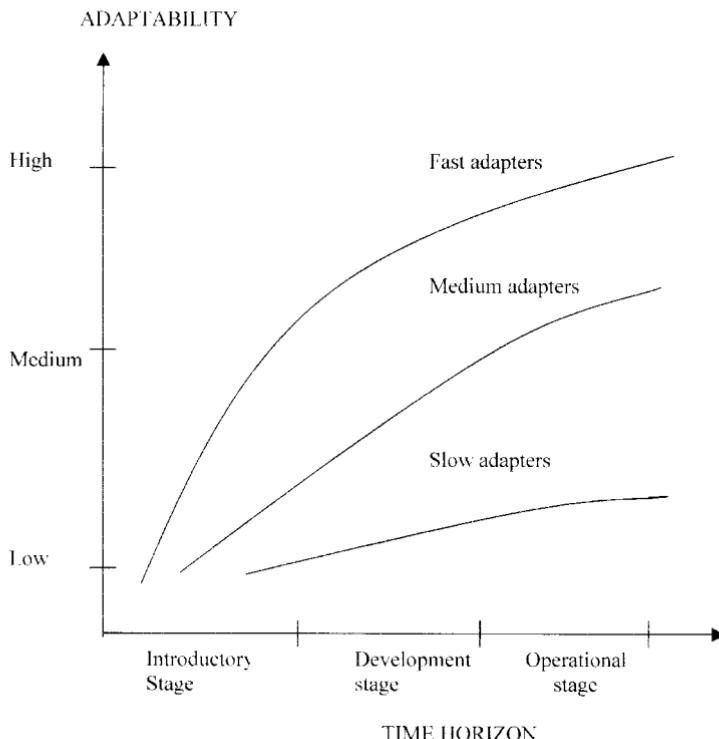


Figure 11.6: Adaptations by alliances operating in the different country groups.

adaptability has naturally been noted in the fast-adapting countries, while slow adapters remained at the same stage, even occasionally regressing, further exacerbating already straitened operational circumstances. For firms operating in fast-adapting countries, the major changes concerned management culture, intercommunication possibilities, predispositions toward engaging initiatives, and the maintenance of symbiotic relationships with state authorities. In the medium-adapting country group, firms also transmuted significantly but not to the same extent as in the first group. For example, Sweden's historical relationship with the Baltic states played an important role in the adaptation process, as well as assisting attitude adjustments of the domestic populations. However, the situation was the opposite in the slow-adapting countries with respect to all major issues; three conditions prevailed therein:

- (1) alliances experienced little change;
- (2) no change at all; or
- (3) adverse change.

From the viewpoints of foreign partners, the reasons for entering ECE have been mainly economic. The choice of region is motivated by pursuit of low-cost production factors — which have largely been observed in most cases but low-cost production (which is more crucial than merely the production *factors*) cannot be ensured unless efficient operation prevails. This explanation is strictly consistent with the transaction-cost approach (Williamson 1975; Hennart 1988), and apparently fits the current study; however, the transaction-cost approach disregards other important criteria, such as non-flexibility and an overriding inability to perceive production as a composition of constituent parts. Because the transaction theory mainly concerns enterprise ownership types where singular ownership concentrates control, it fails to explain how efficiency it is achieved in alliances where control is shared among alliance investors.

Considering the paucity of efficient alliance management, the resource-dependence perspective (Pfeffer & Salancik 1978) may serve as a better explanatory tool, particularly because the case studies show that firms collaborate primarily to ensure a constant supply of critical resources. Control structure is important here as well, but the emphasis is particularly on resource accumulation in order to reduce production uncertainties. The resource-dependence theory, however, is possibly too narrow in that it focuses exclusively on the fulfillment of individual firms' requirements (rather than seeking benefit for joint interests of all partners); i.e. the role of alliance-wide shared objectives are marginalized. In practice, however, alliances discussed in the text exist for the purpose of meeting expectations of both universal and individual natures. Individual goals need not necessarily be inconsistent with those of other partners and of the overall alliance — indeed, they often fit well with the common objectives of the partners' joint mission although harmony usually depends on partners achieving consensus on the relevant issues, as well as developing clear understandings of respective responsibilities (and how they will operate in practice). Therefore, the resource-dependence perspective is somewhat useful when it is concerned strictly with resources, but appears to offer insufficient explanation of multilateral interactions of entire partnerships.

In this study we have observed that when relations function unsatisfactorily, the ultimate performance of the alliance inevitably suffers; this is one of the notable upshots of network theory (Johanson & Mattsson 1988). Maintaining communication ensures that urgent and valuable needs are met, that most

misunderstandings are circumvented, and that the occasional confusions are expediently quelled. The strength of network theory lies in its flexibility and built-in mechanism for handling unforeseen matters. Particular instances have been observed where collaborating firms solved many of the alliance's difficulties by engaging external agents within a broader network. This support has been particularly important for the foreign partners, as they operate in comparatively unfamiliar environments where personal contacts are indispensable to performance. However, knowing even the right people is not always an easy task.

The country classification itself has served as a powerful tool to suggest the extent, nature, and intensity of relationship formation. For example, local support chains were essential for smooth operation of alliances in the slow-adapting countries; since these chains were dominantly absent, the goals of initial alliance establishment went unfulfilled in many cases. In contrast, local support chains in the fast-adapting countries achieved aims to garner local skills and advance on market opportunities. Whatever their goals may be, all actors — especially alliance partners — belong to a vast network, one in which firms organize, operate and protect varied interests.

As might be expected, a goal (both implicit and explicit) of partners is learning from one another how best to operate within the alliance; however, nature and purpose of learning for local and foreign firms have been different. Tsang, in a study (1998) applying foundationally resource-based views, finds that learning processes are meaningless if they are not associated with (and backed by) the necessary sustaining resources. Because firms interpret resources as the foundation of competence development, our current study has also benefited from this theoretical approach. We have observed that learning processes themselves constitute a method of resource acquisition, and skills for such learning are therefore an important human resource. Discovery of resource deficiencies, subsequent methods of corrective acquisition, and optimal utilization thereof, all offer the impression that learning processes are not simply related with resource issues, but that they lend them a fundamental dynamism as well.

Therefore, this study suggests an important extension to Tsang's theory: that learning processes are not only associated with necessary resources but with *dynamic* necessary resources involving manifold human elements. When partners are aware of one another's respective limitations, as well as what might be gained by collaboration, many potential difficulties are avoided. The learning process and judicious allocation of scarce resources not only affect competence development for individual partners, but for the whole alliance as well — case studies offer support of both internal and external standpoints. The

concept of competitive advantage in the resource-based view is therefore applicable on the individual as well as the common level (Barney 1996). If openness is ensured (specifically, if no relevant issues evade disclosure among partners), a favorably symbiotic learning situation will prevail and an environment conducive to developing competence can be established by way of learning processes.

In summary, transaction-cost and resource-dependence perspectives (being control-dominated and somewhat rigid), fail to capture the mechanics and dynamism of alliance activity, whereas the network and resource-based views (being more flexible and pragmatic) are more suitable to our research approach.

## **11.2. Comments on the Theoretical Framework**

The applied theory consists of six variables: motives, performance, resources, learning, networks, and general environmental factors. In this section we discuss these variables in light of the research work, and comment on how or to what extent each has been significant. An effort is also made to observe the degree of interconnections among these variables, and what impact they have on the relationships (alliances) between Western and ECE countries. Although ECE's situations are broadly comparable to those in archetypal developing countries, one might expect a wide gap between ECE and other developing countries with regard to collaboration management due to social, cultural, political, and historical differences. First, we will concentrate on properly understanding these components before subsequent discussions of how they function within the alliance framework. Then, we will focus on where in the alliances the given variables are or are not significant. These observations will be helpful regarding their treatment in future studies, either of a similar nature, or with comparable objectives.

### ***11.2.1. Motives and Performance***

Because collaborations are voluntary, participants must generally be convinced that partnership will create synergistic opportunities or resolve difficulties within the firms that had otherwise been difficult or impossible to expunge internally. Motives are particularly interesting in either of the following situations:

- (1) no similar relationship has ever evolved before (i.e. it is a first-time agreement); or
- (2) such a relationship is already in existence (i.e. the development is an augmentation).

In the first instance, expectations and perceived benefits are of central concern; in the latter, lessons from experience and established trust are the pervasive issues. Extensions of previous relationships have a context of proved (or at least tested) dependability, but a first-time relationship is generally ad hoc, requiring patient development before balance and equilibrium can be achieved. The majority of firms in our study are in such first-time associations, and are thus in a developmental stage dominated by trial-and-error problem resolution. In these cases, motives constitute a relationship-building function within the alliance framework. From this viewpoint, they are necessary conditions for alliances, but not necessarily a component within the alliance process.

The 'performance' variable represents a measure of the alliance's activity, and therefore offers a scope for evaluation of initial expectations and eventual achievements. We have seen that qualitative criteria are more important in these types of assessments because alliances have foundations in fundamentally human elements, beyond purely economic pursuits of profit and market share. An alliance is not only one organization; it is a combination of organizations pursuing joint efforts based on the objective of complementarity. In this light, performance is not a direct activity that takes place within the alliance, it is an outcome of the ongoing process. If a motive is the beginning of the process, performance is its conclusion.

Motives and performance are strongly interrelated as partners continuously evaluate the alliance performance based on the initial motives (see Figure 11.7). There can be three possible outcomes of a collaboration: partners:

- (1) upgrade their expectations due to exceptional performance;
- (2) downgrade expectations due to poor performance; or
- (3) maintain the initial expectations due to satisfactory performance.

Extreme levels of performance (outcomes 1 and 2) may require partners to adjust their motives, but no major changes are required when expectations and outcome are more or less identical (outcome 3). Performance also has indirect effects on motives via the feedback process of previous experiences: since performance is judged on the basis of the initial motives, performance may hence cause reformulations thereof. Motives are established and constantly re-established based on partners' expectations of future returns from alliance

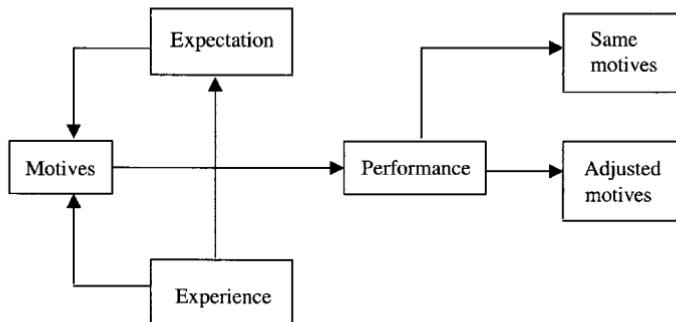


Figure 11.7: Motives, performance and their interrelationships.

activity. These expectations are predicated on the partners' previous experiences, and comprehensions of existing opportunities within the collaboration.

### **11.2.2. Resources and Learning**

In this study, we have seen that resource and performance gaps between partners are generally large, making the issue of complementarity a central concern. Particularly, the 'learning' variable and the scope for learning by both partners has always been influential in the relationships. The learning that has occurred in alliances is of an open type consistent with Tsang's 1998 study: because both partners are aware (at least in theory) of one another's respective strengths and weaknesses, they can quite easily identify circumstances where learning is required. Theory dictates that partners will actively engage aggressive unilateral learning in order to acquire self-sufficiency as quickly as possible, but the learning occurring in these alliances has surprisingly been markedly slow by this benchmark. These learning processes have likely diverged so strikingly from the theory because the partners have been committed to a mutual exchange of resources and intelligence for the purpose of developing competence.

For example, firms in ECE unfamiliar with newer market economies often depend on Western partners to assist in discovery of its mechanisms and the appropriate archetypes of professionalism expected in business activities. Similarly, these firms themselves depend on ECE partners to contribute expertise specific to their own local environment. On both sides of an alliance, the communication barriers presented by cultural disparity are onuses. However, both partners enjoy performance benefits if these relative disadvantages can be mitigated by a synergy of respective advantages. One reason why

partners were not learning competitively could be attributed to openness — the fact that parties did not harbor concealed goals that tacitly marginalized the explicitly stated motives. Partners were largely committed to the set objectives, and worked whole-heartedly to achieve them.

### ***11.2.3. Networks***

Network development has been an important issue for foreign firms engaging in alliance establishment. A network is considered functional when the purposes for alliance formation are unambiguous and uniform among partners that are able to locate and establish valuable contacts. The ECE partners' scope for developing outside contacts has been somewhat restricted, as the western partners often directly assumed responsibility for foreign sales, many times accumulating production inputs themselves if foreign sources were exploited. A distinct link is observed between learning and networks, but this type of relationship is seldom recognized in popular theoretic literature; in contrast, it is argued here that advanced network development is directly related to opportunities for learning. In practice, home country adaptability rates also markedly influenced network development and functionality, with particular disparities observed between the slow- and fast-adapting country group extremes. Although network functionality is not the only factor contributing to learning enhancement, it is a powerful indicator of its objectives and success.

### ***11.2.4. Environmental Factors***

The five variables discussed above are important constituents of the framework, and are mutually helpful in description of the alliance formation process; however, regarding particularly ECE alliances, the general environment's role is unique due to the existence of uniformly wide environmental disparities between partners bridging the European divide. We have shown that unless the effect of the environment is properly captured, no analytical tool will suffice to study the joint collaborations. In the guise of our system of country classification (our adaptation-rate partition), the unfamiliarity and uniqueness of the ECE region's environmental factors were considered when a country's adaptation rate was applied to cases of alliance efficiency. Throughout the study, this classification has been shown to impact the alliance process strongly — indeed, it has exceeded our expectations regarding its analytical usefulness. We therefore make sufficient allowance for country classification in the framework (see Figure 11.8)

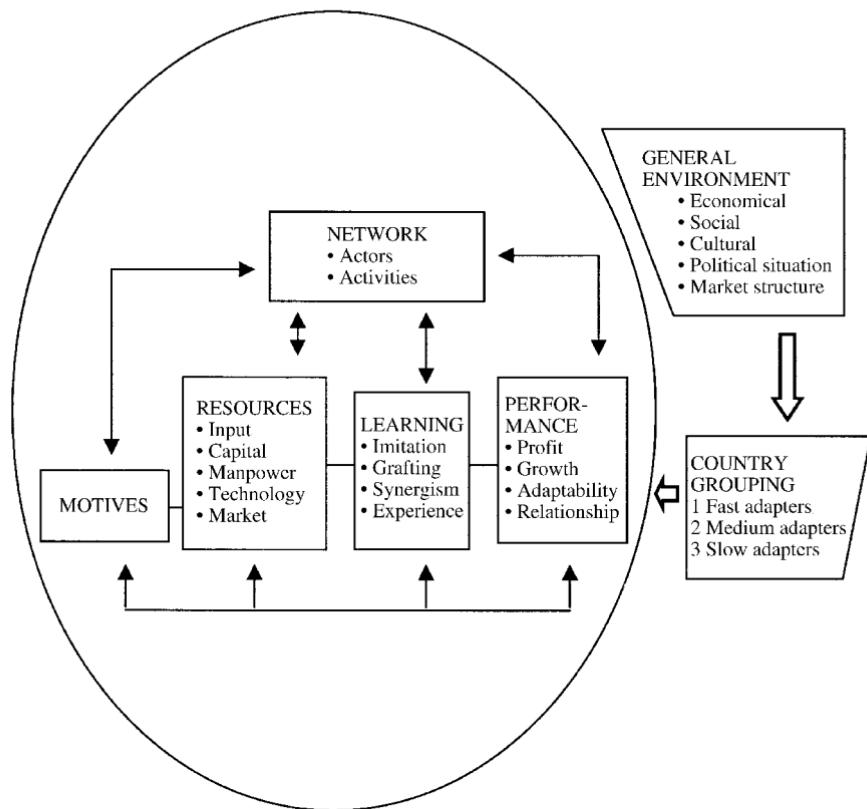


Figure 11.8: The revised theoretical framework.

Different environmental factors have diverse affects on the specific ECE countries, creating disparities in their abilities to host alliances. Direct classification after a simple grouping of the countries based on certain relevant criteria is a suitable method. In fact we have employed this procedure in our study without full awareness thereof, but it is necessary to emphasize that the classification of the countries is not fixed. Because environmental circumstances in ECE are very dynamic, it is likely that classification constituencies will change from time to time — even the number of groups may not be constant. Relative to other variables, if several relationships in several countries are studied, these groupings are natural and reasonable, especially if there is significant variation among the countries.

### 11.3. Alliance Prospects in ECE

The recently increasing rate of FDI in ECE demonstrates a continuation of the region's importance to Western firms, but the significance of the countries as investment objects has not been constant over time due to changing political and investment climates. For example, post-Communist Russia initially attracted a major portion of ECE's foreign investment, but an economic crisis and its concomitant effects on firm operations rendered this trend progressively unsustainable (see Longenecker 2001; Fraser & Zarkada-Fraser 2002). Some ECE countries — e.g. Estonia, Lithuania, Poland and Czech Republic have thus become major beneficiaries of FDI at Russia's expense. Many companies had entered alliances with Russian partners to overcome political hurdles and unfamiliarity with the Russian professional and cultural practices. In some of our case studies, the Russian partners proved to be of limited assistance, but generally far from a level of satisfaction. Not surprisingly, the future prospects in Russia for existing alliances and fresh foreign investment are uncertain (Estrin & Meyer 1998, have expressed similar cautions regarding prospects in Russia). In a case study (Johanson *et al.* 2000), the researchers conclude that inadequate levels of trust, lack of commitment, and scant business activity in Russia complicated developments of efficient commercial practices and constructive relationships with foreign partners. In light of these facts, it may be necessary and appropriate to introduce a fourth group "non-adapters" or "reverse-adapters" with Russia as the dominant member.

The situation of slow-adapting Yugoslavia (Serbia) has also been discouraging, as firms there have had difficulty attracting foreign capital and forming alliances. However, recent developments — particularly the extradition of president Slobodan Milošević to the International War Crimes Tribunal have strengthened the Yugoslav government's international legitimacy; commitments of sizable grants from Western countries to rebuild the extensively war-wrought country are testimony to this fact. Possibly even Western firms will gradually consider investment opportunities in the former Yugoslavia, but this is certain to take time. Although entirely foreign firm ownership is presently allowed in Serbia, initial investments are more likely to occur in the form of alliances because they allow foreign firms to share risks with local firms.

Medium-adapting countries, principally the Baltic States, have recently adopted liberal policies in order to attract foreign capital. There remain needs for ownership-sharing in privatization programs, but these are likely to be met eventually. Evidence in the current study suggests that Baltic government institutions would even fancy selling their shares to foreign partners, but due to

bureaucratic complications this has proved impracticable. Privatization that renders strictly local participation unnecessary creates a duplicitous situation regarding foreign firms' need for local allies in enterprises. Sometimes these needs remain; foreign firms are always benefited by the location-specific skills of domestic partners, and a partitioning of risk premiums. This is an ideal situation for a firm making its debut into a region, but finding financially sound local partners can be a difficulty for foreign firms seeking these first-time collaborations. Also, privatization sometimes obviates local allies altogether; we have observed in our study that some foreign firms have been able to initiate entirely externally-owned subsidiaries alongside their collaborative partnerships with the local partners. Therefore, in medium-adapting ECEs, foreign investment could take either of two forms depending on the circumstances: international alliances, or total ownership by foreign firms.

Regarding FDI within the ECE, Hungary has probably been discussed and researched more than any other country (see e.g. Young 1993; De Kort 1999) because Hungarians have long warmly embraced occidental influences, and have a pragmatic perception of business activities. Consequently, Hungarian firms have received greater portions of foreign capital, and have had unprecedented success adapting to the requirements of the nescient market economy. The form of international investment in Hungary has been almost exclusively of joint-venture type (Neimans 1993); not coincidentally, a large proportion of Swedish firms operating in ECE are located in either Poland or Hungary, and are either such joint ventures or collaborations with entirely domestic ownership. Both being fast-adapters, Hungary and Poland are open and collaborative countries, and the trend of foreign capital inflow is expected to continue into the coming future. Foreign firms have been operating in the ECE region for a comparably long time, and a promising business class has therefore developed (and continues to thrive) there. The particular form of future investment will largely depend on the overall business policy of foreign partners, nature of business, and the opportunities and limitations that prevail. If local supports are necessary, it is understandable that an alliance could be a natural outcome, but the presently dominant joint-venture alliance form can even assume alternate variations — such as product development, market development and research collaborations, where the financial involvement of local partners is negligible.

Interests of foreign firms in collaboration are clearly linked with the political and economical development of the ECEs. Adaptability and flexibility, that is, how efficiently a country is implementing the economical transition process from planned to a market systems, become matters of consideration as well. Privatization is another important issue, which has created favorable

environments for both foreign investment and equity ownership. From the local perspective, external capital is inextricably linked to the modernization of antiquated business enterprises. It is a general observation of the case studies that alliances have difficulty managing an adequate flow of financial resources for running operations. In the fast-adapting, and, to some extent, the medium-adapting ECE countries, some international financial institutions have interceded; however, firms are more commonly forced to refrain from borrowing due to high interest rates. In slow-adapting ECE countries, there has been a dearth of foreign lenders, and hence virtually no borrowing opportunities at all. Also, Clothier (1997) has noted that domestic economies of most ECE countries suffer an extreme paucity of liquidity, a fact implying that the local entrepreneurship will generally seek alliances with foreign firms to procure the financing required for their business projects and future development. Naturally, most such ventures will involve joint ownership of companies and profit sharing for the sake of risk pooling.

#### **11.4. Research Implications**

Our extensive study of alliances has focused on important research areas, particularly in the context of ECE. It has been shown to what extent countries in the region achieved success under the constraints of their particular collaboration's alliance-type, and what measures must be taken in order to improve the overall operating situation and ensure the continuation of smooth function. New issues have surfaced which compel further investigation or full-fledged research initiatives in their own rights — many of them either because they either lie beyond the limited scope of our study, or are philosophically divergent from our focus. A major limitation of the study has been the use of exclusively foreign perspectives, marginalizing those of the ECE partners. While this has not necessarily compromised the research objective, the study would doubtless benefit from a more balanced representation. Given our conclusions, it seems appropriate to reconsider the alliances from the complementary perspective of the ECE partners. Such a future study would be an extension of the current work, and would be of a complementary nature to it. New insights could be captured, and a deeper reporting of the alliances would become possible.

Among the former Soviet Republics, the Baltic States have shown unprecedented propensities for adaptability and improvement, and compel a separate and independent research work of their own. Estonia has been particularly successful, and has quickly garnered considerable respect among

firms in western Europe. Country-specific studies in ECE have so far concentrated on either the 'Visegrad' countries, e.g. Hungary and Poland or Russia (see e.g. Fahy *et al.* 1998; Goldman 1999; Aybar *et al.* 2000). Many studies on Baltic states, such as Ghauri & Holstius (1996), consider important issues, but fall short on requisite comprehensiveness and balance. For example, research studies on Baltic States could focus on:

- (1) recent foreign investments including size, scope and pattern;
- (2) success and failure in collaboration; or
- (3) cultural impact on business environment and new business development.

Networks have become a much discussed research issue in international business. Researchers have shown marked interest in focusing on network relationships in connection with the internationalization process of small firms in particular (see e.g. Coviello & Munro 1997; Tikkainen 1998; Chetty & Blankenburg Holm 2000; Abraha & Awuah 2001). Due to the limited resources of small firms, network formation is considered crucial in these studies. If these firms are going to pursue internationalization, they must build networks with outside parties that can supply absent or complementary resources. The situation of these small firms bears a distinct resemblance to that of firms in ECE, which needed not only resources, but also international export contacts in order to earn stronger currencies. Even foreign firms attempting to engage collaborations in ECE need to foster local network relationships in order to overcome social, political, cultural, and other major differences. Networks have indeed been considered in this study comprising one of the variables in the theoretical framework but proper emphasis proved challenging. It has been observed that thorough investigation of the issue in connection with alliance operation and performance is required; thus, a separate study on networks in alliances is warranted because one would likely reveal new insights.

Another issue is learning, which also requires special consideration in future research. Several matters require consideration: Why is this important in ECE alliances, and for whose interest? Are parties generally willing to participate in mutual learning? Do the partners have a clear-cut idea what their interests should be? What ensures that a conducive environment can exist within the alliances? Specifically how might the learning process function? Other relevant inquiries could multiply virtually ad infinitum. Some of these concerns have been covered in our study, but with limited prominence. Learning has generally been stressed greatly in the organization literature, but no mainstream research to date (at least, none to the author's knowledge) has concentrated exclusively on this issue in ECE alliances. Considering the large number of alliances in the region, a survey could feasibly be conducted; however, since many aspects of

learning in ECE are not yet properly explored and understood, a qualitative approach could also yield significant contributions in this field.

Cultural differences and their impact on alliance relationships in ECE were found to be of critical import in our study. We have incorporated culture as a kind of sub-variable, but have neglected thorough investigation of its deeply complex role. Cultural gaps exist not only between west European and formerly socialist countries; there is a cultural heterogeneity among the ECE countries as well. For example, the Baltic States are widely considered to have similar cultures, but our findings have shown that foreign firms operating in both Estonia and Lithuania have adopted different business strategies specifically because of significant cultural differences between them. Hence, examinations of exclusively cultural factors in ECE alliances are necessary. Therein case studies will be indispensable tools for illuminating both the influence of culture on alliance relationships, as well as ways cultural adaptation has enhanced collaboration functionality. Comparing various instances of alliance success and failure in ECE can give indications as to how cultural factors are manifested, as well as effective ways of accounting for them in practice.

## **11.5. Managerial Implications**

There have been significant cultural gaps between alliance partners, but they have proven anything but uniformly problematic. Language barriers could be mitigated in many cases, but surmounting many other gaps required patience and care. In deliberating appropriate measures for handling these fragile difficulties, the classifications of ECE countries by adaptation rates assume particularly felicitous application. For example, it is usually best for foreign firms in slow-adapting countries to delegate local matters to local partners; indeed, engaging these types of responsibilities themselves are overwhelmingly likely to have catastrophic upshots and result in failure. Hence, finding local partners with competence in local practices is imperative for foreign firms establishing alliances in slow-adapting countries.

It is also a mistake for foreign firms to assume dominion regarding technical expertise and development, as this often marginalizes potentially significant contributions of their ECE partners to innovation and problem solving. Many of ECE alliance partners have invaluable experience operating in their field and serving local customers. This is particularly the case in instances where privatization initiatives have allowed foreign firms to acquire shares in formerly state-run organizations.

We do not find in this study strong support of Ghauri & Holstius' (1996) conclusion that alliance functionality depends on firm-level relationship development, as opposed to the overriding authority of the state. We suggest that, in addition to lower-level state contacts, foreign firms must be well connected with top-level public executives if legitimacy of operations is to be garnered. The activity and performance of the Western partners would at least temporarily be a matter of scrutiny for the ECE authority concerned.

The prospects for financing locally in ECE are definitely improving, but it will take several years before borrowing in the region becomes sufficiently reliable. Because of the risks and uncertainties prevalent in the region, interest rates remain high, so firms entering these countries must meet the operating costs by arranging alternative sources of financing. Pecuniary contributions by local partners, particularly in the medium- and slow-adapting countries, are inconsistent at best, and are usually trifling.

There are two dimensions of network development by foreign firms:

- (1) expansion of local networks to include suppliers, customers, and support bodies; and
- (2) creation of new contacts in neighboring countries.

An existing alliance acts as a base for initiating, organizing, and developing such efforts; foreign firms can either develop both kinds of networks, or concentrate on one type, depending on their ambitions.

Figure 11.9 summarizes the periods of investment and return for three country groups. The figure does not show the size of investments, only the duration of investments that offered no return (by 'return', we mean positive return or profit, i.e. earnings above cost coverage). It has been found that, of the three country groups, fast-adapters offer the most promising prospects in assuring expeditious investment returns. Quite the opposite has occurred for

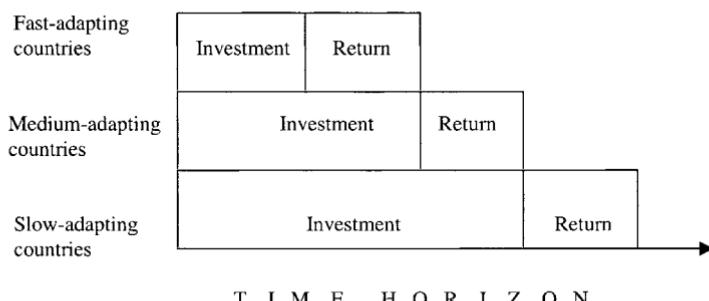


Figure 11.9: Investment and return over time.

alliances with firms in slow-adapting countries; as it is ever mired in the investment period, no firms in this area have yet shown indications of generating revenues over break-even levels. Alliances in the medium-adapting country group have made important strides, some even succeeding in attaining satisfactory returns of their investments. Therefore, it is suggested that firms intent on obtaining fast returns from ECE investments concentrate on fast-adapting countries. On the other hand, for foreign firms operating in alliances with firms in slow-adapting countries, tolerance and obstinacy are two vitally indispensable qualities. Such engagements also require that a firm have sufficient resources and a long-term investment perspective.

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